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Can governments spend their way out?

China's financial diplomacy

Israel's election: Tzipi v Bibi

Why ray guns are back

The rise and fall of Lefty Rosenthal

It's time



Home
This week's print edition
Daily news analysis
Opinion
All opinion
Leaders
Letters to the Editor
Blogs
Columns
KAL's cartoons
Correspondent's diary
Economist debates
World politics
All world politics
Politics this week
International
United States
The Americas
Asia
Middle East and Africa
Europe
Britain
Special reports
Business
All business
Business this week
Management
Business education
Finance and economics
All finance and economics
Economics focus
Economics A-Z
Markets and data
All markets and data
Daily chart
Weekly indicators
World markets
Currencies
Rankings
Big Mac index
Science and technology
All science and technology
Technology Quarterly
Technology Monitor
Books and arts
All books and arts
Style guide
People
People
Obituaries
Diversions
Audio and video
Audio and video library
Audio edition
Research tools
All research tools
Articles by subject
Backgrounders
Economics A-Z
Special reports
Style guide
Country briefings
All country briefings
China
India
Brazil
United States
Russia

Print edition November 1st 2008

It's time
America should take a chance and make Barack Obama the next leader of the free world: leader



Previous print editions
Oct 25th 2008
Oct 18th 2008
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nd

nancial crisis

Middle East & Africa

Israel
Into the electoral maze

Syria
A puzzling raid

Africa's economy
Trying to weather the storm

Slavery in west Africa
A continuing abomination

The Horn of Africa
The tragedy of the decade?

Côte d'Ivoire
Election jitters

Correction: Africa's prospects

Europe

Germany's foreign policy
The Berlin stonewall

Espionage
Snoop and scoop

The euro
Seeking shelter

Croatia
Still a Balkan country

Charlemagne
Europe's baleful bail-outs

Britain

Public finances
So long, Prudence. We had fun but...

Sterling's pounding
Back to earth

Bank regulation
Behavioural finance

A Scottish by-election
Political bubbles

The privileged Conservatives
Class worriers

Prison building
Icebergs ahead

Intelligence
Dimming

Bagehot
Snoek with a kumquat coulis

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International

Policing prostitution
The oldest conundrum

Fighting the nuclear fight
When nuclear sheriffs quarrel

Obituary

Frank “Lefty” Rosenthal

Economic and Financial Indicators

Overview

Output, prices and jobs

The Economist commodity-price index

Income inequality

Trade, exchange rates, budget balances and interest rates

Markets

Cost of remittances

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Politics this week

Oct 30th 2008
From The Economist print edition

Barack Obama and John McCain made one last frantic round of campaign appearances ahead of America's **presidential election** on November 4th. Flush with funds, Mr Obama appeared on prime-time television in a glossy 30-minute campaign ad. National opinion polls narrowed somewhat, but still pointed to a big win for the Democrat. Mr McCain insisted he would prove the pundits wrong and eke out a victory. See article

Those states that allow **early voting** reported a brisk turnout. Gallup suggested that, as of October 27th, 18% of voters had cast their ballots already, and that Mr Obama held a ten-point lead over Mr McCain in that group.

The Democrats were expected to increase their majority in **Congress** on election day. Their chances of securing a 60-seat filibuster-proof majority in the Senate improved with the conviction of **Ted Stevens** on all charges of corruption relating to repairs on his home. The Alaskan senator is contesting his seat in a tight race. Senior Republicans, including Mr McCain, said he should resign. See article

New York's city council voted to amend a law that restricted mayors to two terms in office, which will allow **Michael Bloomberg** to run again. The decision was met with some criticism; New Yorkers have twice voted in favour of the term limit.

Shaking land

An earthquake of magnitude 6.4 struck Baluchistan, in north-west **Pakistan**, killing at least 200 people and destroying hundreds of houses.

India and **Japan** signed a security co-operation agreement during a visit by Manmohan Singh, India's prime minister, to Tokyo. Japan has such a pact with only two other countries—America and Australia.

Dozens of people died in a series of bombings in India's **north-eastern state of Assam**. The authorities blamed separatist insurgents.

AP

A suicide-bomber attacked a government ministry in Kabul, **Afghanistan's** capital. At least five people were killed.

In the latest success for **Indonesia's** anti-corruption agency, Burhanuddin Abdullah, a former governor of the central bank, was sentenced to five years in prison for using bank funds to bribe members of parliament and pay for lawyers to defend bank officials accused of corruption.

In the first truly competitive presidential election in the **Maldives**, Maumoon Abdul Gayoom, president for 30 years, was defeated in a run-off by Mohamed Nasheed, a former political prisoner. See article

The biennial summit of **ASEM**, the Asia-Europe Meeting, convened in Beijing for talks dominated by the global economic downturn. China's prime minister, Wen Jiabao, said his country's "greatest contribution to the world" would be to keep its own economy running smoothly. See article

Drug highs and lows

There was mixed news from Mexico's **drug war**. Police arrested a senior member of the Tijuana "cartel". But it emerged that two senior officials at the attorney-general's office have been arrested on suspicion of working for a trafficking mob. See article

Mexico's Congress approved a much watered-down energy law, allowing Pemex, the state oil monopoly, a bit more financial autonomy. The government had originally wanted to open the country's rapidly declining oil industry to private investment.

Colombia's government sacked three generals and two dozen other army officers. It holds them responsible for cases in which army units boosted their anti-guerrilla credentials by murdering unemployed youths and claiming that their bodies were those of dead guerrillas. See article

In municipal elections in **Brazil**, Gilberto Kassab, the incumbent mayor of São Paulo, easily won a second term, defeating a leader of President Luiz Inácio Lula da Silva's governing Workers' Party. Lula had better luck in Rio de Janeiro where Eduardo Paes, an ally, narrowly defeated Fernando Gabeira, a centrist ecologist best known for having kidnapped the American ambassador during Brazil's military dictatorship of 1964-85.

Budapest blues

Reuters

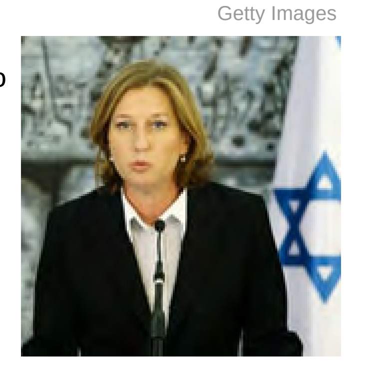


The **IMF** created a $100 billion fund that it will offer to countries that are basically sound, but which may need short-term loans to boost their cash reserves and aid their currencies during the financial crisis. Meanwhile, the IMF took the lead in a $25 billion rescue package for **Hungary**, which has seen its currency and stockmarkets battered by the global financial crisis. The IMF also offered a $16.5 billion bail-out of **Ukraine**, and provided $2 billion to **Iceland**.

In **Lithuania**, Andrius Kubilius, the leader of the conservative Homeland Union party, was asked by the president to form a governing coalition with three other centre-right parties following a general election.

To the polls

Getty Images



The new leader of the main party in **Israel's** ruling coalition, Tzipi Livni, said she had been unable to form a new majority coalition, so a general election is to be held in February. An early opinion poll put her Kadima party a shade ahead of the main opposition party, the right-wing Likud, led by Binyamin Netanyahu. See article

American special forces raided a village just inside **Syria's** border with Iraq in a purported effort to catch or kill an al-Qaeda leader. But the Syrian government, accusing the Americans of a war crime, said that eight civilians, including a woman and three children, had been killed. See article

At least 28 people in **Somalia** were killed in five suicide-bombings in one day, presumably by jihadists stepping up their campaign against the beleaguered government. The highest death toll was in Hargeisa, capital of the breakaway northern region of Somaliland. Two days earlier a woman was stoned to death for adultery in the southern port of Kismayo, which jihadists captured in August.

Rebel forces in north-eastern **Congo** loyal to a Tutsi general, Laurent Nkunda, took the town of Rutshuru and looked set to take Goma, the capital of North Kivu province; UN peacekeeping troops seemed unable to stop them. Some 250,000 civilians have fled their homes since a peace accord fell apart in August. See article

Business this week

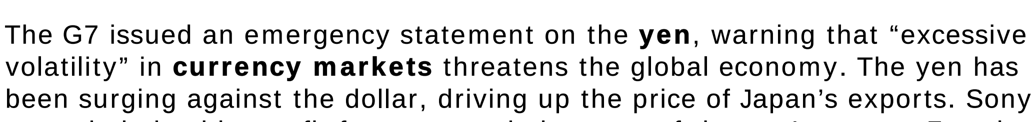
Oct 30th 2008
From The Economist print edition

America’s Federal Reserve cut its benchmark **interest rate** by 50 basis points, to 1%, its lowest level since June 2004. China’s central bank also shaved interest rates for the third time in six weeks. See article

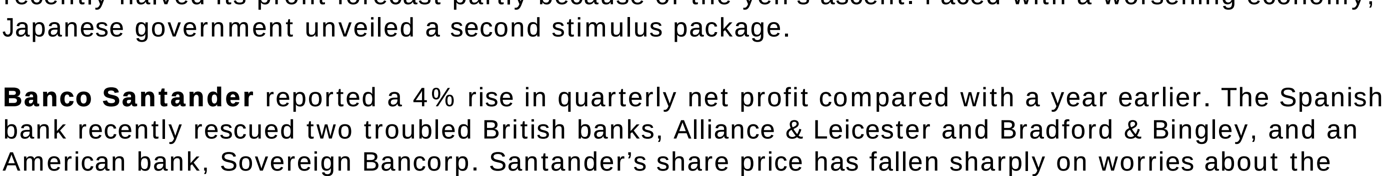
American **consumer confidence** plunged in October to reach the lowest point yet measured by the Conference Board, which started its index in 1967.

Free fall

Asian stockmarkets suffered another tumultuous week. The **Nikkei** average reached its lowest level in 26 years, with bank stocks coming under particular pressure. Investors were perturbed by the news that **Mitsubishi UFJ** had to boost its capital by raising ¥990 billion ($10.7 billion) in a share offering. Japan’s biggest bank recently agreed to take a 21% stake in Morgan Stanley for $9 billion, and paid $3.5 billion to take full control of Union Bank of California.



The G7 issued an emergency statement on the **yen**, warning that “excessive volatility” in **currency markets** threatens the global economy. The yen has been surging against the dollar, driving up the price of Japan’s exports. Sony recently halved its profit forecast partly because of the yen’s ascent. Faced with a worsening economy, the Japanese government unveiled a second stimulus package.



Banco Santander reported a 4% rise in quarterly net profit compared with a year earlier. The Spanish bank recently rescued two troubled British banks, Alliance & Leicester and Bradford & Bingley, and an American bank, Sovereign Bancorp. Santander’s share price has fallen sharply on worries about the financial health of its Latin American business.

Mid-sized banks in America began tapping the government’s $250 billion recapitalisation programme. Capital One and SunTrust were included in a slate of financial companies to which the Treasury Department said it would provide capital. **PNC** became the first bank to use some of the funds it received to finance a merger, with **National City**, a stricken lender.

Kuwait’s government came to the aid of **Gulf Bank** after it revealed a big loss from trading in currency derivatives for a client. As Kuwaitis started withdrawing their money from Gulf in droves, the central bank guaranteed all bank deposits and started an inquiry. Gulf Bank’s boss promptly resigned, but not before stockmarkets tumbled throughout the region.

Microsoft unveiled **Windows Azure**, its new strategy to compete in “cloud computing”. Azure will run on remote servers and allow users to access and store applications over the internet, rather than using software installed on their computers.

Google agreed to pay $125m to establish a Book Rights Registry that settles a lawsuit, brought by the Authors Guild and publishers, accusing the company of infringing copyright by scanning **books** online. Readers will now be able to read snippets of books on the web, with an option to buy and print the whole work. See article

Surprise!

Volkswagen briefly became the world’s largest company by stockmarket value when its share price rocketed after **Porsche** revealed that it held 74% of the carmaker, much more than had been thought. Because the German state of Lower Saxony holds another 20%, **hedge funds** rushed to cover their short positions, forcing up the price of an ever- decreasing number of available shares. With the funds facing

massive losses, Porsche, which reaped an equivalent profit, offered to sell 5% of the shares back to the market. See article

Delta Air Lines and **Northwest Airlines** completed their merger after obtaining the approval of antitrust officials. More consolidation in the airline industry beckoned when Germany's **Lufthansa** said it would take majority control in **bmi**, a British carrier. The deal could challenge British Airways' dominance at Heathrow, especially if Lufthansa and bmi are joined by Virgin Atlantic.

High energy

Britain's **BG Group** made a A$5.6 billion ($3.5 billion) friendly offer for **Queensland Gas**. The deal underscores the interest in Australia's coal-seam gas reserves. The methane reserves are converted to liquefied natural-gas, which is keenly sought after in the Asia- Pacific region. BG was recently rebuffed in an attempt to take over Origin Energy, which instead formed a partnership with ConocoPhillips.

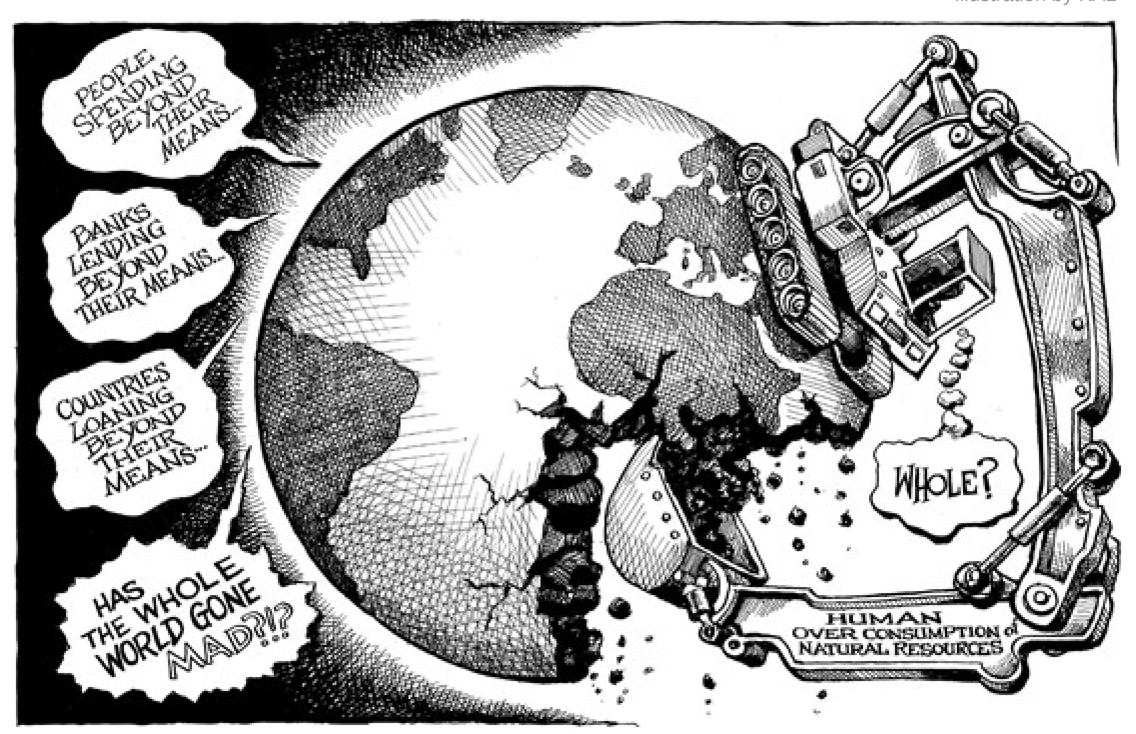
OPEC's decision to cut its output of **oil** by 1.5m barrels a day did little to stop oil prices from hurtling towards $60 a barrel, compared with a peak of almost $150 in the summer. They crept up, however, when interest-rate cuts fed hopes of stronger global economic growth.

Economist.com OPINION

KAL's cartoon

Oct 30th 2008
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Illustration by KAL






The presidential election

It's time

Oct 30th 2008
From The Economist print edition

America should take a chance and make Barack Obama the next leader of the free world



IT IS impossible to forecast how important any presidency will be. Back in 2000 America stood tall as the undisputed superpower, at peace with a generally admiring world. The main argument was over what to do with the federal government's huge budget surplus. Nobody foresaw the seismic events of the next eight years. When Americans go to the polls next week the mood will be very different. The United States is unhappy, divided and foundering both at home and abroad. Its self-belief and values are under attack.

For all the shortcomings of the campaign, both John McCain and Barack Obama offer hope of national redemption. Now America has to choose between them. *The Economist* does not have a vote, but if it did, it would cast it for Mr Obama. We do so wholeheartedly: the Democratic candidate has clearly shown that he offers the better chance of restoring America's self-confidence. But we acknowledge it is a gamble. Given Mr Obama's inexperience, the lack of clarity about some of his beliefs and the prospect of a stridently Democratic Congress, voting for him is a risk. Yet it is one America should take, given the steep road ahead.

Thinking about 2009 and 2017

The immediate focus, which has dominated the campaign, looks daunting enough: repairing America's economy and its international reputation. The financial crisis is far from finished. The United States is at the start of a painful recession. Some form of further fiscal stimulus is needed (see article), though estimates of the budget deficit next year already spiral above $1 trillion. Some 50m Americans have negligible health-care cover. Abroad, even though troops are dying in two countries, the cack-handed way in which George Bush has prosecuted his war on terror has left America less feared by its enemies and less admired by its friends than it once was.

Yet there are also longer-term challenges, worth stressing if only because they have been so ignored on the campaign. Jump forward to 2017, when the next president will hope to relinquish office. A combination of demography and the rising costs of America's huge entitlement programmes—Social Security, Medicare and Medicaid—will be starting to bankrupt the country (see article). Abroad a greater task is already evident: welding the new emerging powers to the West. That is not just a matter of handling the rise of India and China, drawing them into global efforts, such as curbs on climate change; it means reselling economic and political freedom to a world that too quickly associates American capitalism with Lehman Brothers and American justice with Guantánamo Bay. This will take patience, fortitude, salesmanship and strategy.

At the beginning of this election year, there were strong arguments against putting another Republican in the White House. A spell in opposition seemed apt punishment for the incompetence, cronyism and extremism of the Bush presidency. Conservative America also needs to recover its vim. Somehow Ronald Reagan's party of western individualism and limited government has ended up not just increasing the size of the state but turning it into a tool of southern-fried moralism.

The selection of Mr McCain as the Republicans' candidate was a powerful reason to reconsider. Mr McCain has his faults: he is an instinctive politician, quick to judge and with a sharp temper. And his age has long been a concern (how many global companies in distress would bring in a new 72-year-old boss?). Yet he has bravely taken unpopular positions—for free trade, immigration reform, the surge in Iraq, tackling climate change and campaign-finance reform. A western Republican in the Reagan mould, he has a long record of working with both Democrats and America's allies.

If only the real John McCain had been running

That, however, was Senator McCain; the Candidate McCain of the past six months has too often seemed the victim of political sorcery, his good features magically inverted, his bad ones exaggerated. The fiscal conservative who once tackled Mr Bush over his unaffordable tax cuts now proposes not just to keep the cuts, but to deepen them. The man who denounced the religious right as "agents of intolerance" now embraces theocratic culture warriors. The campaigner against ethanol subsidies (who had a better record on global warming than most Democrats) came out in favour of a petrol-tax holiday. It has not all disappeared: his support for free trade has never wavered. Yet rather than heading towards the centre after he won the nomination, Mr McCain moved to the right.

Meanwhile his temperament, always perhaps his weak spot, has been found wanting. Sometimes the seat-of-the-pants method still works: his gut reaction over Georgia—to warn Russia off immediately—was the right one. Yet on the great issue of the campaign, the financial crisis, he has seemed all at sea, emitting panic and indecision. Mr McCain has never been particularly interested in economics, but, unlike Mr Obama, he has made little effort to catch up or to bring in good advisers (Doug Holtz-Eakin being the impressive exception).

The choice of Sarah Palin epitomised the sloppiness. It is not just that she is an unconvincing stand-in, nor even that she seems to have been chosen partly for her views on divisive social issues, notably abortion. Mr McCain made his most important appointment having met her just twice.

Ironically, given that he first won over so many independents by speaking his mind, the case for Mr McCain comes down to a piece of artifice: vote for him on the assumption that he does not believe a word of what he has been saying. Once he reaches the White House, runs this argument, he will put Mrs Palin back in her box, throw away his unrealistic tax plan and begin negotiations with the Democratic Congress. That is plausible; but it is a long way from the convincing case that Mr McCain could have made. Had he become president in 2000 instead of Mr Bush, the world might have had fewer problems. But this time it is beset by problems, and Mr McCain has not proved that he knows how to deal with them.

Is Mr Obama any better? Most of the hoopla about him has been about what he is, rather than what he would do. His identity is not as irrelevant as it sounds. Merely by becoming president, he would dispel many of the myths built up about America: it would be far harder for the spreaders of hate in the Islamic world to denounce the Great Satan if it were led by a black man whose middle name is Hussein; and far harder for autocrats around the world to claim that American democracy is a sham. America's allies would rally to him: the global electoral college on our website shows a landslide in his favour. At home he would salve, if not close, the ugly racial wound left by America's history and lessen the tendency of American blacks to blame all their problems on racism.

So Mr Obama's star quality will be useful to him as president. But that alone is not enough to earn him the job. Charisma will not fix Medicare nor deal with Iran. Can he govern well? Two doubts present themselves: his lack of executive experience; and the suspicion that he is too far to the left.

There is no getting around the fact that Mr Obama's résumé is thin for the world's biggest job. But the exceptionally assured way in which he has run his campaign is a considerable comfort. It is not just that he has more than held his own against Mr McCain in the debates. A man who started with no money and few supporters has out-thought, out-organised and out-fought the two mightiest machines in American politics—the Clintons and the conservative right.

Political fire, far from rattling Mr Obama, seems to bring out the best in him: the furore about his (admittedly ghastly) preacher prompted one of the most thoughtful speeches of the campaign. On the financial crisis his performance has been as assured as Mr McCain's has been febrile. He seems a quick learner and has built up an impressive team of advisers, drawing in seasoned hands like Paul Volcker, Robert Rubin and Larry Summers. Of course, Mr Obama will make mistakes; but this is a man who listens, learns and manages well.

It is hard too nowadays to depict him as soft when it comes to dealing with America's enemies. Part of Mr Obama's original appeal to the Democratic left was his keenness to get American troops out of Iraq; but since the primaries he has moved to the centre, pragmatically saying the troops will leave only when the conditions are right. His determination to focus American power on Afghanistan, Pakistan and proliferation was prescient. He is keener to talk to Iran than Mr McCain is— but that makes sense, providing certain conditions are met.

Our main doubts about Mr Obama have to do with the damage a muddle-headed Democratic Congress might try to do to the economy. Despite the protectionist rhetoric that still sometimes seeps into his speeches, Mr Obama would not sponsor a China-bashing bill. But what happens if one appears out of Congress? Worryingly, he has a poor record of defying his party's baronies, especially the unions. His advisers insist that Mr Obama is too clever to usher in a new age of over-regulation, that he will stop such nonsense getting out of Congress, that he is a political chameleon who would move to the centre in Washington. But the risk remains that on economic matters the centre that Mr Obama moves to would be that of his party, not that of the country as a whole.

He has earned it

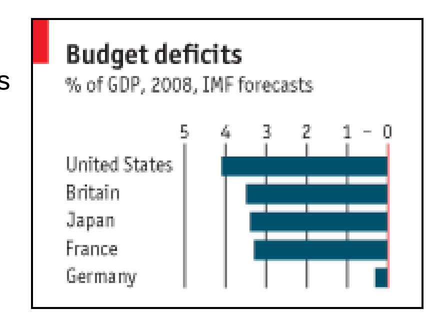
So Mr Obama in that respect is a gamble. But the same goes for Mr McCain on at least as many counts, not least the possibility of President Palin. And this cannot be another election where the choice is based merely on fear. In terms of painting a brighter future for America and the world, Mr Obama has produced the more compelling and detailed portrait. He has campaigned with more style, intelligence and discipline than his opponent. Whether he can fulfil his immense potential remains to be seen. But Mr Obama deserves the presidency.

The economy

The next front is fiscal

Oct 30th 2008
From The Economist print edition

Interest-rate cuts are welcome; but as a global recession looms, the case for fiscal stimulus grows



THE good news is that the world seems to have dodged a catastrophic banking collapse. It is too early to know for sure—some emerging markets are in trouble and stockmarkets are behaving violently (see article). But interbank and commercial-paper markets suggest that the blind panic is abating.

The bad news is that the world economy is weakening fast. Across the globe falling asset prices, tighter credit and declining confidence have left firms and consumers unable or unwilling to spend and invest. In America consumer confidence has collapsed to its lowest-ever reading (see article). In Germany the Ifo index, a gauge of business confidence, has sunk to a five-year trough. Because the downturn is now global, it is harder for exports to make up for weak domestic demand. The odds of a long, nasty recession are growing. So, too, is the case for more government action to counter weak private demand.

The usual mechanism is through interest rates. Economic orthodoxy looks to central bankers to smooth demand, because short-term interest rates are easier to calibrate than tax and spending and are controlled by technocrats rather than politicians. America's Federal Reserve cut its policy rate by a further half point, to 1%, on October 29th. Held back by fears of inflation, Europe's central banks have cut much less—a timidity that ought to be abandoned now that the risk of inflation is evaporating: both the European Central Bank and the Bank of England should cut rates boldly at their meetings next week.

But it would be a mistake to expect too much from rate cuts. The financial system's stresses have made them less effective, as banks hoard cash and scale back lending. And in America, at least, short-term rates have little room to fall further. So the next policy front should be fiscal (see article).

When credit markets are dysfunctional, private demand is fading and confidence weak, a fiscal jolt is a good option. Cutting taxes puts extra cash straight into people's pockets. By stepping up their own spending, governments can directly boost demand and employment. True, stimulus increases short-term government deficits—but the fiscal damage from a prolonged slump would be greater still, as Japan showed in the 1990s. With the private sector unwilling to spend and nervous investors clamouring for safe government bonds, there is little risk of crowding out private investment.

Some countries have more scope for fiscal stimulus than others. Many governments in emerging markets, especially those with big external deficits, will be limited by investors' unwillingness to hold their debt. That is why Hungary tightened its budget this week. At the other extreme lies China—with huge foreign-exchange reserves, and a current-account and budget surplus. Within the rich world, countries such as Italy, with ageing populations and high debt burdens, have less room. So, too, do those with smaller, less liquid debt markets.

America has the greatest scope for short-term stimulus, despite running the world's biggest current-account deficit. That is because dollars and Treasuries rank as safe havens nowadays. Also, because its taxes are lower and social-safety nets less generous, America has fewer "automatic stabilisers" than Europe, where spending on unemployment benefits automatically rises further in a downturn. America's fiscal federalism tilts in the opposite direction: most states must run balanced budgets and so cut spending in hard times. It has already had a boost worth $168 billion or just over 1% of GDP (mainly through tax rebates). Sensibly, Congress is planning another, of 1-2% of GDP, soon after the election.

Europe, too, may need a fiscal stimulus before long. Spain already has a package; Germany is considering one. Britain's Chancellor, Alistair Darling, paved the way on October 29th by scrapping the

government's old fiscal rules (see article). The next day, Japan unveiled a ¥5 trillion ($51 billion) package, much of it supposed to go directly to families and small firms.

Let's get fiscal

A stimulus should be timely, targeted and ideally contain credible plans for long-term fiscal health. But there are no magic recipes. Tax cuts get cash to consumers, but people may choose to save the money or spend it on imports. Government spending, say on infrastructure, might have lasting benefits, but it has a long lead time and is often wasted. Help for particular groups, such as homeowners or car firms, has political appeal and, for over-indebted homeowners, an economic logic. But, in general, helping a specific industry is a bad idea.

The scale and mix of a stimulus will differ by country. In America federal aid to the states makes a lot of sense. In Europe a cut in value-added taxes would be good. China should boost social spending. So far, governments have courageously fended off financial catastrophe. The darkening outlook means that they may soon have to show fiscal courage too.




Elections in Israel

Tzipi or Bibi?

Oct 30th 2008
From The Economist print edition

Peace depends less on Israel's choice of prime minister than on the actions of America's next president

AP



IT SEEMS to happen every time. The moment Israel comes close to getting a prime minister serious about making peace with the Palestinians, fate steps in to block the way. Yitzhak Rabin was assassinated; Shimon Peres was rejected by the voters; no sooner had Ariel Sharon come round to ceding (far too little) land for peace than he was felled by a stroke. Ehud Olmert let himself be dragged into a calamitous war in Lebanon and now Tzipi Livni, a punchy politician from the right who has seen the light and started negotiating in good faith with Mahmoud Abbas, the Palestinian president, has tripped at the final fence in her bid to take Mr Olmert's place.

In Ms Livni's case, the failure was self-inflicted. Mr Olmert is stepping down amid a blizzard of corruption allegations. Had Ms Livni been able to tempt enough of Israel's many parties into a coalition, she could have taken over without facing the voters. But she refused to give two religious parties what they demanded: money for their special causes and a pledge not to talk to the Palestinians about Jerusalem. The upshot is that Israel will hold an election in February. And although early polls put her ahead, there is a fair chance that Israelis will vote instead to bring back the Likud's hawkish former prime minister, Binyamin ("Bibi") Netanyahu (see article).

That puts the peace process into cold storage for the time being. But in the Middle East there is always a silver lining, or at least a dull grey one. Here, in ascending order of brightness, are three consoling thoughts.

The least consoling is that in spite of the talks Mr Olmert and Ms Livni have been having with the Palestinians, the peace process was not going anywhere anyway. At George Bush's behest at Annapolis a year ago, Mr Olmert and Ms Livni have been exploring their differences with Mr Abbas, but they have got nowhere near to narrowing them enough to give Mr Bush the agreement in principle he wanted before leaving the White House. And it could only ever have been "in principle" because the Palestinians are divided and Mr Abbas does not speak for Hamas, which runs the Gaza Strip and commands the loyalty of many Palestinians in the West Bank too.

A more consoling observation is that if Mr Netanyahu does win in February, that need not kill all hope of peacemaking. It is a fallacy that peace in the Middle East can be achieved only when Israelis vote in a dove. Hawks can make peace too: Begin bought peace with Egypt by handing back the Sinai peninsula. Even Mr Netanyahu had, with bad faith and worse grace, to go along with parts of the Oslo peace process (withdrawing from most of Hebron and signing the Wye accords) when he was prime minister in the

1990s. He was pushed in this direction by two forces: American pressure and the desire of most Israelis to extricate themselves from endless conflict.

The lessons learnt

The brightest consolation is that neither of these forces is extinct. All but a minority of Israelis have learnt from two Palestinian *intifadas* that the notion of a Greater Israel extending from the sea to the river is yesterday's fantasy. The separation barrier, though hated by Palestinians, has made Israelis understand that they can hold on at most to the sliver of the West Bank containing the most thickly populated settlements. Mr Olmert, himself a former Likudnik, said recently that Israel would have eventually to give up almost all the lands it conquered in 1967, including the Arab parts of Jerusalem.

The main question for most Israelis is not whether to withdraw, but the more perplexing when—and how to do it safely. These questions can be answered only with some tough love and hands-on diplomacy from an engaged America. Like many presidents, Mr Bush waited too long to show an interest in Palestine. Distracted by wars in Afghanistan and Iraq, and repelled by the duplicity of Yasser Arafat, he gave Mr Sharon a free pass, extracting nothing more than Israel's unilateral withdrawal from Gaza, a gamble that backfired.

In January, however, a new president will have a chance to push for peace. Whether it is Barack Obama or John McCain, he should grab it early. Palestine cannot be the priority of a president who has also to save capitalism, finish two foreign wars and stop the world melting. That is why appointing a senior envoy (an ex-secretary of state would be nice) is a good idea. So is Mr Obama's plan to test cautiously whether Syria, Iran or both can be lured into diplomacy.

The new man will take office before Israelis go to the polls. It is not his job to tell Israelis who to vote for, but Israelis like their prime ministers to be *persona grata* in Washington. So the new president should make an early statement of tough intent that includes a demand for Israel to fulfil its promises to stop expanding settlements and dismantle the outposts deep in the West Bank. Blame for the impasse does not lie with Israel alone. But if Israel intends to leave one day, it had best start proving it—not least to its foremost ally.

Congo

Don't let it happen all over again

Oct 30th 2008
From The Economist print edition

The United Nations must be given more and tougher peacekeepers to prevent a catastrophe



OF ALL the many tragic countries in Africa, Congo comes closest to the caricature that Africans bitterly and understandably resent: Joseph Conrad's "heart of darkness". It was the most brutally treated of all the territories conquered by Europeans. It has been grossly exploited by all its rulers, white and black. It heaves with mineral riches yet virtually no wealth has trickled down to its 60m people. With a GDP per person of less than $500 a year, most Congolese die before their mid-40s. There is scant sense of nationhood. Millions of people, in a country that is sub-Saharan Africa's second biggest, live in swathes of jungle, barely linked to the rest of the country, let alone to its capital, Kinshasa. Truly it is one of the world's worst-run countries—and one of the hardest to mend. Now, even by its own dire standards, it is entering a worse phase than usual. Yet no one really knows how to help it.

After the downfall in 1997 of Mobutu Sese Seko, one of the most rapacious dictators of all time, things fell apart once again. During six years of civil war some 5m Congolese are reckoned to have died of disease and other effects of lawlessness. Now, two years after a UN-sponsored election that was heralded as a harbinger of stability at last, the same old horrors are threatening to engulf the eastern part of the country. A rebel force is poised to capture Goma, one of Congo's main towns. Some 250,000 civilians have fled their homes since August. Perhaps most shocking of all, the UN's 17,000-strong peacekeeping force, its largest mission anywhere, is failing ignominiously in its prime task: to protect the lives of civilians.

Blue-helmeted shame

The first requirement is for the UN, on the ground and in the Security Council, to get a grip of itself. Its force commander, an experienced Spaniard, has resigned in despair seven weeks after taking over. The Indian units that make up the core of the UN force in the area under attack have given up on the Congolese army, which has disintegrated in the face of rebels from the Tutsi group. Moreover, command and control among the peacekeepers, not to mention their discipline, have been poor. The blue helmets have incurred the enmity of the locals, the rebels and the useless, predatory Congolese army. Plainly, the peacekeepers need reinforcing fast, with the right sort of troops. Instead of wringing its hands, the UN Security Council must resolve to send a robust force of extra troops forthwith.

The biggest snag is that the kind of troops who could make a difference are not readily available. Many countries belonging to NATO, the world's best fighting force, are overstretched in such places as Iraq and Afghanistan. That rules out the British and Americans. The promised deployment of a hybrid UN-African Union force in Sudan's ravaged Darfur region is flagging badly. France's forces have performed well in Congo before, but its government has awkward relations with Rwanda, which backs the main rebel force. South Africa, which already provides troops to the UN force, could play a bigger part in the danger zone. Perhaps the UN could mandate the EU to find a force fast. It is vital that havens be created for the fleeing civilians—with protection by forces who can actually fight.

Diplomacy must be applied too. There are no angels in this war. But the immediate cause of the latest upheaval is the assault by the Tutsi rebels of General Laurent Nkunda on Goma and their attempt to control the province of North Kivu; the general, who says he just wants to protect his fellow Tutsis, is egged on by the Tutsi-led government of next-door Rwanda, which is a favourite of many Western governments, especially America's. Rwanda's President Paul Kagame is best placed to rein in General

Nkunda's men, and must be pressed to do so, with the threat of aid withheld if he does not. In the long run, he must also make political space in Rwanda for the Hutu rebel forces who maraud through eastern Congo and give General Nkunda a pretext for his depredations. That will be especially hard, since many of those rebel Hutus helped commit genocide, mainly against Tutsis, in Rwanda 14 years ago.

In the even longer run, it is questionable whether Congo will ever hang together as a proper country. It is a hideous mess and always has been. But no one has yet contrived a way of reordering it without prompting even greater bloodshed and chaos. So the Congolese and outsiders, the UN included, just have to keep trying against the odds to make it work.



On capitalism, Afghanistan, climate change, Iceland, Joe Biden, Joe the Plumber

Oct 30th 2008
From The Economist print edition

The wealth of nations

SIR – Having been in Asia during the financial crisis a decade ago, I am struck by the similarities between then and now ("Capitalism at bay", October 18th). A property boom gone wild; opaque financial systems (if bank executives can't grasp the complexities of their business, they must be opaque); central banks supporting for years a policy of easy money; rampant short-selling.

The only ingredients missing are the snide voice of the IMF denouncing bank nationalisations and the American trade representative demanding that weak banks go bust. Whatever happened to "let the markets decide", which in 1998 was sold as economic truth to Asian countries? Is the medicine of shock therapy, so liberally handed out to South Korea, Thailand, etc, too bitter for the doctor?

Christian Kober
Chief operating officer
Geberit Shanghai Trading
Shanghai

SIR – It was the actions of politicians rather than the greed of capitalists that caused problems in the financial system to build up until they collapsed under their own weight. Politicians presided over habitual national deficits, undisciplined borrowing and exploding money supply. It is they who claimed it was impossible to spot asset bubbles, except in hindsight, despite systemic, irrational exuberance in property prices and stockmarkets.

They are the ones who turned blind eyes to the concoction of credit and who validated the new paradigm of leveraging inflated assets as a way to spend, rather than saving the old-fashioned way. Let the facts speak for themselves. If politicians had not behaved so recklessly, the world would be a safer, more prosperous place and prudently governed countries like Australia would not have to take costly action to avoid the worst of the contagion.

Government irresponsibility is why we are where we are and if that original sin had not been committed we wouldn't now be talking about bankers' salaries.

Maurice Newman
Sydney

SIR – Your rather sombre defence of capitalism reminded me of the late John Kenneth Galbraith, who said once that one of man's oldest exercises in moral philosophy is the search for a superior moral justification for selfishness.

Murali Reddy
Lake Hiawatha, New Jersey

SIR – Those of us who worked at *The Economist* in the late 1940s shared John Maynard Keynes's consensus view of the hungry 1930s. We believed then that distance had added no enchantment to Stanley Baldwin, a Tory centrist, and Ramsay MacDonald, Britain's last previous too right-wing Scots Labour prime minister. They wasted in mass unemployment a decade of under-demand that should have been used for national development. They echoed the muddle of the 1931 May committee in supposing that tightened budgets were morally needed in great depressions.

Today's clones of Baldwin and MacDonald are not just David Cameron and Gordon Brown. Terrifyingly, they include both Barack Obama and John McCain.

Since the present credit crunch will bring longer under-demand than did the Wall Street crash in 1929, Britain's wisest and most Keynesian policy would be an income-tax holiday for at least the poorer half of its too many income-taxpayers. This temporary increase of about £40 billion ($60 billion) to the annual budget deficit would be spent by its beneficiaries on the (probably mostly service) activities that are a rough snapshot of Britain's next £40 billion of most-likely growth industries once the slump is over. Add in free trade for all imports from countries with cheaper labour, and fears that the budget deficit could bring inflation during the under-demand sound oxymoronic.

The probably imminent President Obama seems intent on punishing bust Lehman banks by making the better-run American banks uneconomic, through imposing such political over-regulation that every First National Bank of Anywhere would have to employ hugely expensive teams of lawyers. Britain's aim should be to avoid such a plague, and to make London the cheapest centre to run any bank from. Instead we are trying to establish international cartels that forbid banking competition between countries, and we boast that these bail-outs will cost mega-billions, which nobody can possibly afford.

Norman Macrae
London

SIR – If I have learnt anything from my 15 years of working in the brokerage divisions of five banks it is that there are very few examples of leadership or teamwork in the banking world. There are hardly any (good) role models to follow, managers with little experience of management, no loyalty, and no corporate conscience, all of which leads to a lack of collective responsibility.

Placing stricter regulations on banks is one thing, but we also need to put real leaders in charge of the banking sector, men and women who are truly ethical and can create a new banking regime and re-engineer the corporate culture of these institutions. We need to recruit financially savvy managers from industrial companies with strong corporate cultures, such as Nestlé and P&G, and let them run the banking world.

As long as banks remain mere collections of individuals, the situation will continue to be like herding cats. Hosing them with water now and then will chase them off and make them wary about returning for a while. But one day they'll be back to feed on our greed and to make a disgusting mess in our backyard.

James Amoroso
Consultant
Walchwil, Switzerland

SIR – We have heard the justification that banning bonuses "would drive good people out of companies that badly need them" for some time now from those who try to justify the outrageous remuneration paid to managers in the financial industry. It is nonsense. As a former director of a large bank I say let them go. It is plain to see for everybody where the inventiveness of these bonus-maximisers has led us. There are plenty of talented, competent and honest people within the ranks of our banks who are eager to do a better job at a quarter of the salaries paid to their present bosses.

Heini Lippuner
Oberwil, Switzerland

SIR – Your cover portrayed a wounded lion struck by hunters' arrows, symbolising an ailing capitalism. Shareholders like myself would like to indulge in a new sport over the next few years: hunting down arrogant and stubborn bank bosses who lost trillions of dollars. I am certain that when the dust clears we will see a few banking chief executives put behind bars. Now that is a cover of *The Economist* I would like to see.

Julian Suresh Candiah
Kuala Lumpur

Ending a conflict

SIR – Your advice about the best way to overcome the Taliban was steeped in the old recipe of divide and rule ("No time to go wobbly", October 18th). With war fatigue clearly visible on both sides, it is diplomacy that is now required to nudge the parties to the table. The negotiation process will be arduous,

but it will be less painful than continuing current hostilities.

The mothers, wives and children of all sides want an end to this war, but it is being fuelled by unacceptable “collateral damage” from both sides of the border. A Pushtun is a fine and proud person. He loves his rifle and his old wife and strongly believes in revenge if unjustly wronged.

A. Rauf Khan Khattak
Islamabad

Forestry management

SIR – You reported on how the planet is losing species at an incredible rate, and that the threat of climate change may hasten the pace of such losses (“Fewer creatures great and small”, October 18th). To prevent catastrophic climate change we must stabilise emissions in such a way to keep the rise in global temperature as far below 2ºC as possible. Otherwise we will reach certain climate tipping-points, potentially losing 20-30% of species as well as a significant loss of the Amazonian rainforest, for example. However, one of the solutions you identified—to include forests in carbon markets—would be counterproductive.

Allowing cheap forest-offset credits into the carbon market could significantly reduce the price of carbon, creating a perverse effect that substitutes for the required cuts in industrial emissions. One option to avoid this is to require countries and companies to pay for a small portion of the carbon permits they currently receive free under the Kyoto protocol. We estimate that an annual auction of only 3% of these emission allowances would yield €14 billion ($17 billion) to pay for forest protection. While this approach is necessarily “linked” to the market, it would avoid the problems of directly including forest credits in the carbon markets.

Patrick Venditti
Head
Forest Campaign
Greenpeace International
Amsterdam

Ditching the krona

SIR – So the current joke doing the rounds is: what is the capital of Iceland? About $4.50. But think again (“Divided we stand”, October 18th) about the fate of a small country on the fringes of the European Union. Its mostly foreign-currency denominated markets dived to the point where the government had to nationalise its banks, only to discover that its own, highly exposed local currency declined so much the country became bankrupt.

Iceland now has no choice but to join the euro, whatever the cost. Britain will one day do the same; the only question is when and under what circumstances. It would be great if politics could step aside and a decision taken on the long-term economic benefit, especially if we don’t want that very expensive joke to be on us one day.

Baron Frankal
Manchester

In the words of Biden

SIR – Lexington made a gratuitous attack on Sarah Palin when he described her as a “dumb populist” (October 18th). It would have been more meaningful if he had compared Mrs Palin with her counterpart, Joe Biden, who has made some horrendous gaffes.

Mr Biden has declared that Franklin Roosevelt went on television in 1929 to address the Wall Street crisis, despite Herbert Hoover being president at the time, when TV was not commercially available; apparently believes that America has “kicked Hizbullah out of Lebanon”; and thinks that today’s main worry of the middle class “is a three-letter word: J-O-B-S”.

E. G. Martin
Williamsburg, Virginia

Political truths

SIR – At the risk of having my water cut off, it seems perhaps that certain senators share some traits with certain plumbers ("The last word", October 18th). Consider that they are prone to promise much more than they deliver, hopelessly underestimate costs, and leave a mess to clean up when they leave.

Mike Colling
Corvallis, Oregon

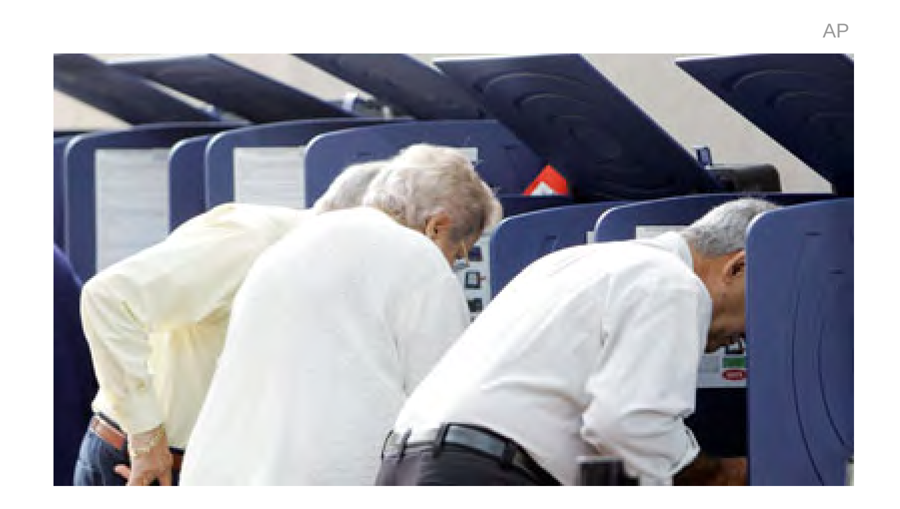
Age and America's election

Age shall not wither them

Oct 30th 2008 | LADY LAKE, FLORIDA
From The Economist print edition

The elderly are America's most reliable voters; the young are newly enthused this year. We discuss the impact both groups are having, starting with the old

AP



A RECENT morning in Florida offered a glimpse of the future. A restaurant in The Villages, about one hour from Orlando, teemed with supporters of Barack Obama, their devotion expressed on pins, signs and T-shirts. Countless such gatherings have been held across the country. But this group was, for lack of a better word, old, and as fired up and ready to go as any cluster of college students. Sue Michalson, a county leader, had Mr Obama's "CHANGE" poster taped to her walker. The scene was to be expected. The Villages is a retirement community, but the future will be filled with time-worn faces like these.

America's older population already has considerable clout. In 2004 adults aged 55 and up comprised 31% of the electorate but 35% of voters; roughly one in five voters was 65 or over. The old are a critical block in at least two of the main swing states: Florida and Pennsylvania. The biggest crowd gathered for any Republican event yet this year was, amazingly, in The Villages for an appearance by Sarah Palin, a testament both to her drawing power and to the interest the old feel in politics.

For much of the campaign, those 65 and older eluded Mr Obama's steady sweep across the country. But in the final stretch John McCain has found it hard to keep this base as Mr Obama has whittled away at it. In October each candidate announced plans to help the elderly through the current economic crisis—$2 trillion of their retirement savings have evaporated over the past 15 months. New ads from the Obama campaign claim that Mr McCain would cut Medicare, the health-care programme for the old; Mr McCain denies this adamantly. But in the race for the grey vote, the two men are now running neck-and-neck.

This lively fight portends a broader shift. If presidential candidates court the old now, in future they may grovel before them. The first of 78m baby boomers, born between 1946 and 1964, are now in their 60s. By 2040 about one in five Americans will be aged 65 or older, compared with one in eight in 2000.

This is hardly news, and America as a whole is still younger than countries such as Japan or Italy. Nevertheless, Americans are only beginning to face the possible impacts of an ageing population. In 2000 there were 4.5 working adults for every nonworking adult aged 65 and older; by 2020 that number will drop to 3.3, according to a paper from the Urban Institute, a think-tank. Entitlements—Medicare, Social Security (the government's pension system) and Medicaid (health care for the poor and home care for the old who cannot afford it)—already account for 40% of federal spending. Without reform or a stark increase in taxes, there will be little money for investment or spending for other programmes.

The need to avoid future chaos has mostly been outweighed, on the campaign trail, by the need to get elected now. Amid financial mayhem, Mr Obama and Mr McCain are wisely addressing immediate

problems for older voters. The tougher debate, however, is over how to care for them in the long term. "It is hard to get elected when you are promising pain," explains Richard Johnson of the Urban Institute.

The old will play a main role in choosing the next president, and future ones. They care about the issues that other Americans do, namely the economy and national security. But particular efforts to woo them will inevitably have a broad impact on everyone else.

The golden years

America's current predicament stems from the middle of the last century. The Social Security Act of 1935, the rise of corporate pensions and the creation of Medicare in 1965 together formed a grand new social contract, as Marc Freedman describes in his book "Encore". The old would no longer fear years of poverty. Americans would, for the first time, have guaranteed income for their old age. Union leaders and politicians laid the foundations for retirement, but Del Webb, a developer, built the dream. In 1960 Webb opened the first big retirement community. The idea of the "Golden Years" did not exist until Webb's company invented it.

Nowhere is this vision more fully realised than in The Villages, home to about 70,000 people scattered across three counties. WVLG, the local radio station, plays songs such as "Blame it on the Bossa Nova" and "Big Girls Don't Cry". Golf carts are the favoured mode of transport. Fred and Jean Wix have one refurbished to look like a 1929 Ford truck. Its horn suggests a wheezing elephant, just like the original.

It is doubtful, however, that future generations will retire in such comfort. Mrs Wix has a pension from 3M, a conglomerate based in Minnesota; Mr Wix has a military pension from serving in the Marines. Defined-benefit (DB) plans, which guarantee a monthly income based on past pay and length on the job, remain common in the public sector. But for private workers they are increasingly a perk of the past. In 1980 39% of workers in the private sector participated in traditional DB plans. In 2006 just 20% did.

To replace DB plans, many firms have defined-contribution (DC) schemes, such as 401(k)s, in which employees contribute money to individual investment accounts. These have their own problems. Workers and employers alike put piddling sums into such accounts. Half of private-sector workers do not even have an employer-sponsored retirement plan, according to AARP, the elderly's main lobby group.

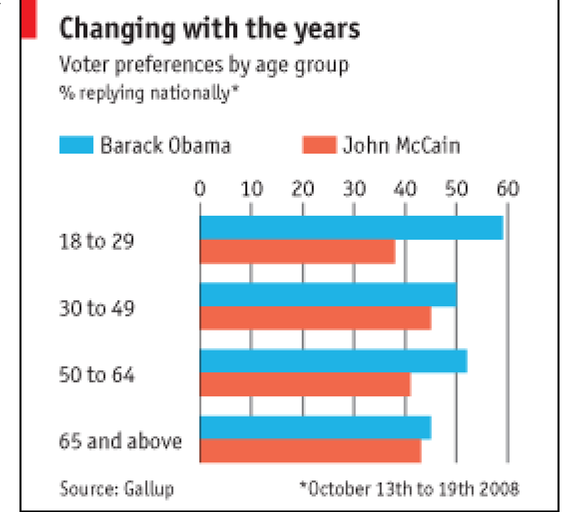
In this landscape, public money remains a crucial support for retirees: 52% of couples and 72% of singles who receive Social Security rely on it for at least half their income; 20% of couples and 41% of singles rely on it for at least 90% of income. The financial crisis may make new retirees more dependent. The government, with ever mounting debt, will strain to fulfil its promises to them.

Social Security was never meant to cover workers for decades. In the 1930s the retirement age was set at 65 and the average woman lived to 62, the average man to 58. (In fairness to Franklin Roosevelt, infant mortality skewed this a bit.) Now, however, workers can get cheques at 62, with full benefits available at 66. The average life expectancy is 78. Payments must be made over a longer period and, as the boomers age, to a growing cohort. The Social Security trust fund is expected to be insolvent by 2041. The Congressional Budget Office (CBO) projects that spending on Social Security will rise from 4.3% of GDP to 5% in ten years and about 6% in 25 years. Those of working age will bear the burden.

George Bush, to his credit, waded into the toxic waters of reform, advocating that Americans divert a portion of Social Security taxes into private accounts. This failed miserably, thanks in part to AARP, whose lobbying in the capital is reinforced by advertisements and the spectre of 39m members ready to barrage Congress with letters.

Before the financial crisis Mr McCain said he was open to the idea of private accounts. These days he prefers to be vague. Mr Obama would boost saving by enrolling all workers in a retirement plan. To pay for Social Security (and much more), Mr Obama favours raising taxes for those earning more than $250,000, a measure that Andrew Biggs of the American Enterprise Institute has lampooned for transforming Social Security into a welfare plan. Neither candidate, however, likes to dwell on the details.

That Social Security has become political cyanide does not bode well. "We have much worse problems," explains Gary Burtless of the Brookings Institution, a think-tank, and points to spending on health care. The CBO estimates that federal spending on Medicare and Medicaid will rise from 4.6% of GDP now to 6% in ten years and 12% by 2050. The addition in 2003 of Medicare Part D, which expands coverage to prescription drugs, has made the programme more expensive. Medical inflation, not the ageing population, will be the main driver of costs.



Relief now, problems later

AARP has centred its election efforts on health care, an issue that affects its members in particular but all voters too. The lobby's "Divided We Fail" advertisements pervade television news networks; volunteers in "Divided We Fail" T-shirts are a staple of any campaign rally. AARP does not endorse candidates, but both Mr Obama and Mr McCain have dutifully signed a "Divided We Fail" pledge to reform.

Still, a debate on Medicare is only beginning to emerge. On October 17th the Obama campaign began running an ad that begins, "How would your golden years turn out under John McCain? His health-care plan would cut Medicare by $800 billion. That means a 22% cut in benefits." The McCain campaign has furiously rebutted such charges. Beneath this rhetoric, both candidates are searching for ways to save money without cutting benefits. Mr McCain's ideas include promoting health IT, cutting fraud and improving treatment for chronic conditions; Mr Obama's include encouraging home-based care, negotiating lower drug prices and reducing subsidies to private plans in Medicare. Such detailed discussion, however, is mostly buried by alarmist attacks.

Promising relief now is easier than drafting a long-term solution. In pursuing the old, both candidates have proposed a hotch-potch of ideas for the immediate future. Mr Obama has long promised that he would eliminate income taxes for the elderly earning less than $50,000; he now wants to send them cheques immediately as a "down payment" on future cuts. Both he and Mr McCain want to waive a rule that requires those aged 70½ and older to begin withdrawing cash from their retirement accounts. But each would also incentivise others to take money out. Mr McCain would temporarily let those 60 and older withdraw money from their retirement plans at a low tax rate of 10%, while Mr Obama would let families withdraw as much 15% (up to $10,000) without penalty until the end of 2009.

Bob Williams of the Tax Policy Centre says that Mr McCain's policy would benefit the rich most. "If we're talking about Joe the retired plumber", he says, "it is not clear that this does much to help him." Mr Obama's scheme would help those in need of cash, but it would also encourage others to deplete their savings.

In the midst of this confusion, older voters are gravitating towards Mr Obama. This may be the final blow to Mr McCain, who could have used their support to offset his opponent's lead among the young (see article). Mr McCain had won the elderly against the odds. Older voters are now less Democratic as a whole—those who came of age under Roosevelt are being replaced by the "I Like Ike" clan. But the hippies are ageing too. Fifty per cent of those born in 1955 and earlier lean to the left, compared with less than 40% who lean to the right, according to the Pew Research Centre. Yet older, socially conservative voters have been less enamoured of Mr Obama than their youthful counterparts. Just 45% of those 50 and older saw Mr Obama as able to bring real change, compared with 61% of voters under 30, according to a Pew poll published in September. But in most polls Mr Obama now ties Mr McCain for the support of those aged 65 and older.

This shift may help put Mr Obama in the White House. Whether he will tackle entitlements once he gets there is a separate question. In Christopher Buckley's "Boomsday", a satire about Social Security reform, young protesters storm Florida, seizing golf carts and plunging them into water hazards. It may not come to that, but reform remains elusive.

As politicians in Washington continue to muddle along, the sands are already shifting. AARP's pledge for "Divided We Fail" has a hint of what is to come: it calls for "policies that help ensure that all workers—regardless of age—can continue to work and contribute to society." One answer to the prospect of mass

retirement is to delay the exodus. If every worker delayed retirement by five years, they would not only have more income for later years, but their income and payroll taxes would begin to fill the funding gap for Social Security, according to the Urban Institute. The financial crisis may make work a necessity for many. According to a new AARP survey, 65% of those aged 45 and older are considering delaying retirement. Mr Obama is supposedly the face of the future, but Mr McCain, a 72-year-old seeking a new job, may be a more accurate symbol.

The youth vote

Their poster boy

Oct 30th 2008 | AUSTIN
From The Economist print edition

Will young voters carry Barack Obama to victory in November?

Reuters



YOUNG Americans love Barack Obama. Voters between the ages of 18 and 29 favour him over John McCain by whopping margins—59% to 38%, according to the October 19th aggregate from Gallup. His campaign offices teem with bright young staffers and volunteers. His face adorns t-shirts, tote bags and dorm-room walls. The internet has been overrun with tributes. If it were up to young people, Mr Obama would have been elected by acclamation long ago.

All of that is rather good news for the Democrats. Young voters are notoriously unreliable in elections, but there are so many of them that they matter anyway. Only half of voters under 30 turned out in 2004, and that added up to 21m votes. If they pull most of their weight this time, Mr McCain will find himself in a hopeless position. Young professionals in Virginia and Colorado, for example, are helping to push those Republican states to Mr Obama. And Mr Obama seems to have solidified his position in Wisconsin and Michigan, partly thanks to support from students and other young people.

Yet to some strategists the youth vote is all hype, and young voters are not the force they have been cracked up to be. These sceptics say that they have heard this story before. The 2004 election was supposed to mark a turning-point in American politics. Young voters, indifferent in the 1980s and 1990s, would leap off the couch and take to the polls, showing the country and the world that a new generation had arrived. They were fired up as never before: angry about the Iraq war, worried about the economy and fed up with George Bush. Online tools were making it easier than ever to organise. Volunteers around the country had registered hundreds of thousands of new voters. Democrats reckoned that young voters could put their candidate, John Kerry, over the top.

That is not quite how it worked out. The 2004 election did see a significant surge among voters between the ages of 18 and 29. According to the Centre for Information & Research on Civic Learning and Engagement (CIRCLE), 49% of young voters turned out, up from 40% in 2000. But turnout jumped in every age category. And despite all the excitement, young voters still turned out at a lower rate than middle-aged people and geezers. The youth vote went for Mr Kerry by a nine-point margin, but it was not enough to offset Mr Bush's margins with everyone else.

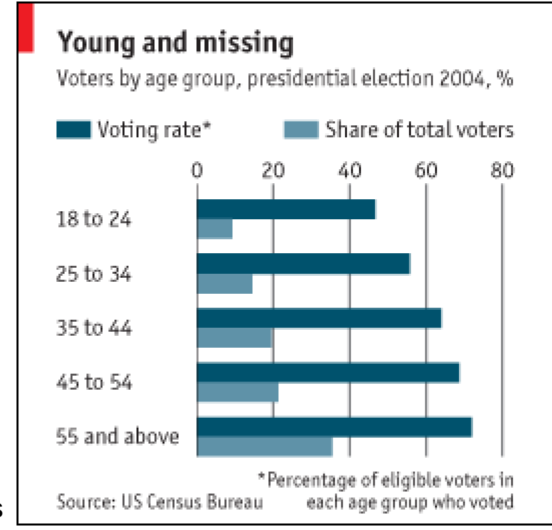
Youth organisers swear that this year will be different, and are pushing ways to increase turnout. They have even more ways to make contact with potential voters, including Facebook (launched in 2004) and Twitter (2006). And they have a few achievements under their belt. Turnout among young people helped Democrats win a few Senate seats in 2006. Also, young voters put Mr Obama on the path to the Democratic presidential nomination. In Iowa, the first contest of the season, youth participation almost tripled. The under-30 voters gave him most of his margin of victory. And the state, which was Republican in 2004, now strongly favours the Democrats.

There is another change from 2004. Mr Kerry was a reasonable but slightly dull fellow who owed much of his support from young voters to their contempt for Mr Bush. However, the polls suggest that Mr Obama himself is genuinely popular. Some commentators think this faddish. But Katie Naranjo, the president of the College Democrats of America and a student at the University of Texas, points out that people are sometimes popular for a reason. "He's talking about the environment, jobs and college affordability in almost every speech," she says.

Perhaps Mr Obama's greatest advantage among young voters is that his opponent is not doing much to contest the category.

This is a strange lapse on Mr McCain's part, because he was once an independent-minded Republican who could chip away at the Democratic advantage among young people. He criticised his party's inaction on climate change, refused to be drawn into the culture wars and railed against corruption in Washington. He even made a cameo appearance in the "The Wedding Crashers", a rowdy summer blockbuster.

But as a candidate, Mr McCain has not paid much attention to young voters. He has few high-profile ambassadors to young people, although one of his daughters writes a blog. He has decided that he supports drilling, after all. His website lists 23 "coalitions", including Bikers for McCain and Lebanese-Americans for McCain. There is no Youth for McCain.



In touch with the age

And in picking Sarah Palin as a running-mate, the campaign has revived the culture wars. This seems to have gone down badly with young people, who are generally more liberal than their parents on social issues and are not interested in squabbles that started before they were born. Older evangelicals may care about issues like abortion and gay marriage. But young evangelicals list poverty, the environment and Darfur as their top concerns.

Mr McCain may have thought he could win this election without young voters. But in a close race, even the bikers will make a difference. And Republicans should have another cause for concern, too: party affiliation tends to be habit-forming. Many of those young Obama enthusiasts will be solid Democrats in the years to come.

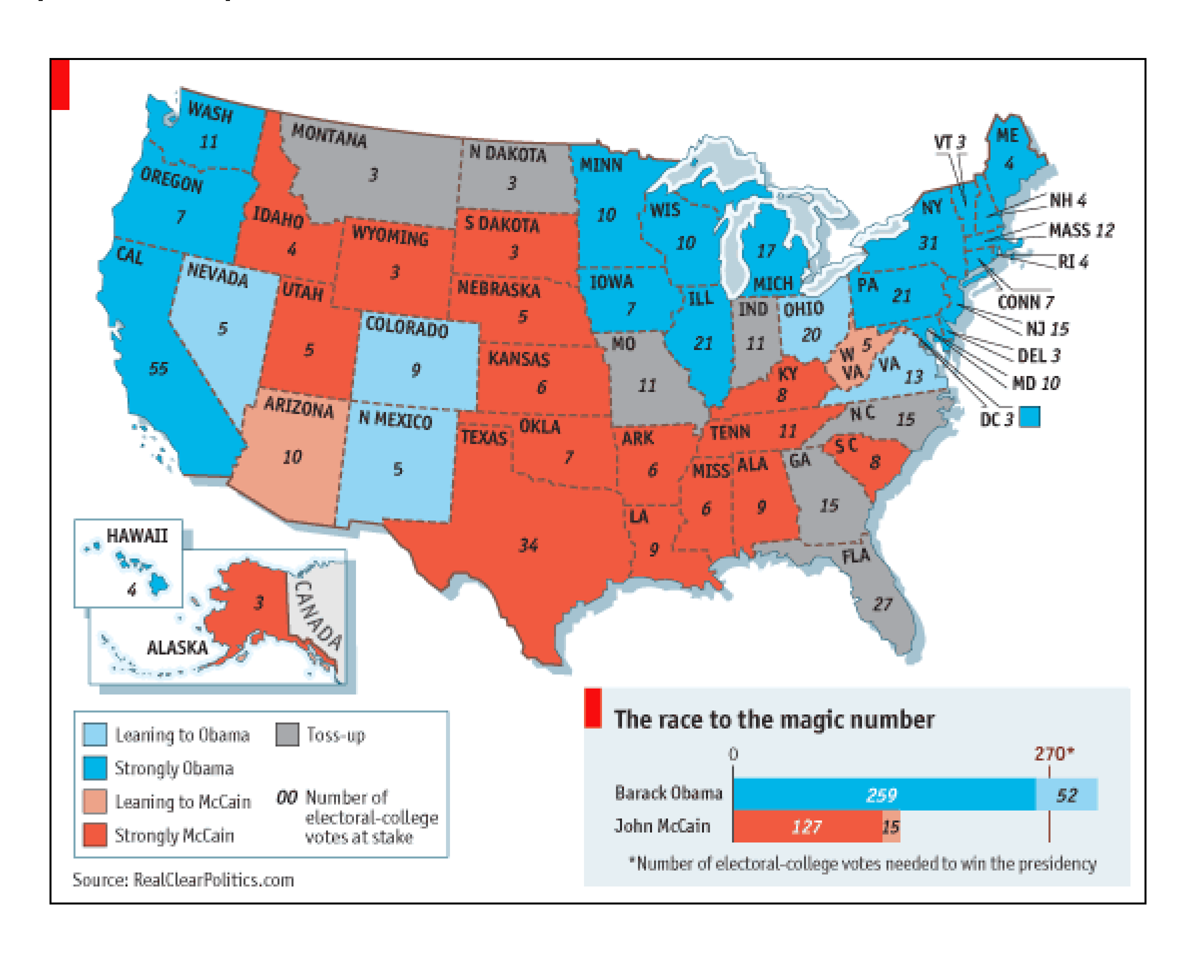


Swing states: our conclusions

To 270...and beyond

Oct 30th 2008
From The Economist print edition

Local polls are predicting a bad night for John McCain and big changes to the landscape of American presidential politics



FOR the past 14 weeks, starting with Ohio back in August and ending last week in Pennsylvania, our correspondents have fanned out across America's swing states, the ones that we guessed would be most likely to determine this year's fiercely fought election. It is now time to put together everything we have learnt along the way. The news is bleak for John McCain.

Under the system handed down by the wary framers of America's constitution, the president is not elected directly, but by an electoral college in which each state casts a number of votes roughly proportional to its population. With two tiny exceptions (see article), states cast their votes in a block for whichever candidate wins the most votes there.

This means the overall popular vote is much less important than the vote in a dozen or so states where the race is particularly close. That is why America's three largest states—California, New York and Texas—have been once again irrelevant to this presidential election. The first two are so reliably Democratic, and the third so reliably Republican, that they have not been contested at all. (Over time this can change hugely: post-war California mostly voted Republican until 1992, whereas Texas, like most of the South, was usually Democratic until the 1980s.)

To win the presidency, a candidate needs to secure a majority of the 538 electoral-college votes. Firmly Democratic or Republican states leave neither candidate with anywhere near the magic number of 270: hence the hustle for the swing states.

When the general-election campaign got under way after Barack Obama clinched the Democratic

nomination in June, most analysts reckoned about 12 or 13 states were up for grabs, carrying with them about 150 electoral-college votes. The unexpectedly strong showing of Mr Obama has pushed the number of states in contention up a bit: at the start of the contest, no one imagined that such states as Indiana and Montana, both of which George Bush won last time by 20 points, could be regarded as close. Now they are.

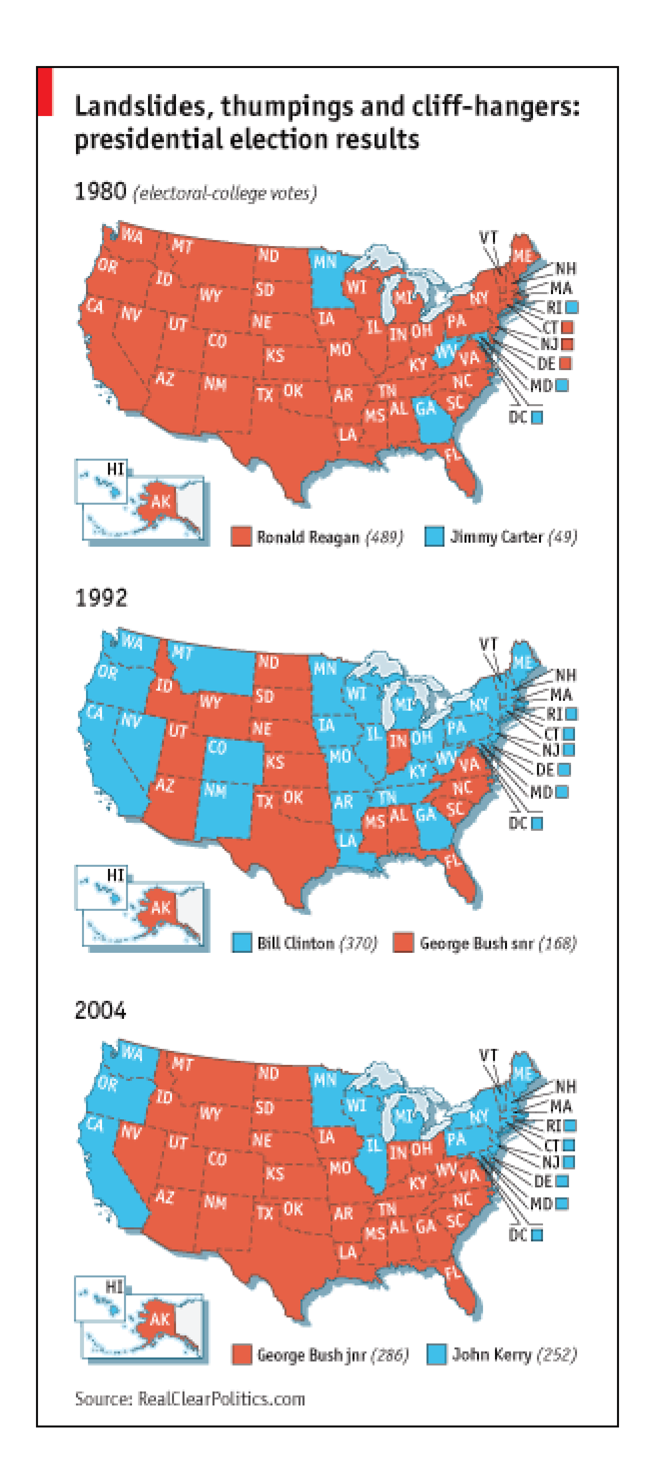
The most dramatic change, though, is how the swing states are swinging. In 2004 Mr Bush defeated John Kerry by 286 electoral-college votes to 252, so all Mr McCain needed was to hold onto those states to win again. He could even afford to lose a couple of smaller ones, like Colorado (nine college votes), or New Mexico (five).

To add to his chances, Mr McCain had some hope of capturing a few states that voted Democratic in 2004: he has always been popular in New Hampshire (four votes), where he beat Mr Bush in the presidential primary in 2000, and where this year his primary victory started his road to the nomination. He also had reason to believe that culturally-conservative blue-collar Democrats, who voted en masse for Hillary Clinton in the primaries and who pollsters said had big doubts about Mr Obama, might give him Pennsylvania (21 votes) or Michigan (17) or Minnesota (ten) or Wisconsin (also ten). These four depressed industrial states voted only narrowly for Mr Kerry, by margins of 2.5, 3.4, 3.5 and 0.4 percentage points respectively.

But none of this has come to pass. According to RealClearPolitics.com, which runs polls of polls for all 50 states, each of the five McCain targets is now “solid” for Mr Obama, meaning he has an average lead of ten or more points in recent polls. Mr McCain still entertains hopes of a game-changing upset in Democratic-controlled Pennsylvania, the sixth-biggest state in the union. But with an 11-point mountain to climb, his chances there look very iffy. Mr McCain’s battle, therefore, is strictly a defensive one.

Reverses on all fronts

And not one that he is winning. Going back to the 2004 battle, the Democrats’ losing margin was 34 electoral-college votes, meaning they need to switch states worth only 18 votes to win. Seven of these votes now seem be in the bag: Iowa looks solid for Mr Obama. Mr McCain’s honesty has been his problem there. He has made no attempt to hide his opposition to subsidies for ethanol and for the bloated farm bill in general; and he barely bothered to contest Iowa’s caucuses. Barring scandal, crisis or extreme incompetence on the part of the pollsters, Mr Obama therefore needs to find only 11 more votes.



There are only so many places to look. The Pacific West and the north-east are all firmly Democratic already: the Great Plains firmly Republican. So Mr Obama has been hunting in three regions: around the Great Lakes, which means Ohio, nearby Missouri and (incredibly) Indiana, since the rest is Democratic already; in the Mountain West; and most remarkably in the South. If the polls are to be believed, he is on the verge of repainting these last two areas, almost entirely Republican red for the past two elections, a fetching shade of purple.

Mr Obama's chances look best in the Mountain West. Colorado, New Mexico and Nevada all lean his way (by which the pollsters mean he has an average lead of more than five points but less than ten). And amazingly, Mr McCain is only marginally ahead in Montana. All four states already have at least one Democratic senator apiece, and Colorado, Montana and New Mexico have Democratic governors. But they are all small states: victory here will not a landslide make.

More is at stake around the Great Lakes, but it is a hard fight. Ohio (see article) has always been one of America's most finely-poised battlefields. The polling there is erratic, but Mr Obama seems to be in with a good chance; if he takes Ohio, with its 20 votes, a solid victory is in the making. In Indiana and Missouri, the polls are nail-bitingly close, with Mr Obama very narrowly in the lead in both. Were he to win just one of these three, all Republican in 2004, that, coupled with Iowa, would put him over the edge. Thanks to his vastly greater campaign chest, and his superior get-out-the-vote mechanisms, he could win all three, painting the whole of America's north-eastern quadrant Democratic blue.

It is probably the South, though, that will be most closely watched on election night. According to RealClearPolitics's averages, Mr Obama is ahead in three southern states: Virginia (by an almost unassailable average of 7.6 points), Florida, with its rich haul of 27 electoral-college votes, by an average of 3.5 points, and most remarkably, perhaps, by 1.3 points in North Carolina. Virginia and North Carolina have much in common. Both these old southern states have been Republican for decades: Virginia last voted Democratic in 1964, North Carolina in 1976. But both have undergone big demographic changes. Northern Virginia has become a yuppified suburb of Washington, DC; Charlotte, North Carolina, is America's biggest financial centre after New York. In both, a large black vote coupled with a large upscale white vote looks favourable for Mr Obama. Even Georgia now seems to be in play.

Florida, as so often, is a case all by itself, with a big anti-Castro vote among Latinos offsetting the Democratic leanings of long-standing local blacks and retired east-coasters. Until a few weeks ago, Mr McCain could depend on this 27-vote electoral treasure. But America's property collapse is acutely felt in Florida, and Mr Obama is narrowly ahead here as well. If Florida goes his way and all the other states in which he leads follow suit, Mr Obama is looking at winning 30 states and 375 electoral-college votes.

Given America's huge internal and external problems, that is a little surprising: even at best, Mr Obama cannot expect a landslide like Franklin Roosevelt's first win in 1932 or Ronald Reagan's in 1980. He might, though, secure a thumping victory like Bill Clinton's first hurrah in 1992, when he made deep inroads in both the South and the Mountain West. Even if he does not match that, the polls have him on track for a far better margin than the painfully narrow ones of the past two elections.

Maine and Nebraska

In search of the one

Oct 30th 2008 | OMAHA, NEBRASKA
From The Economist print edition

The quest for every last electoral vote reaches some unlikely places

TUCKED in a strip mall in Omaha, near a Chuck E. Cheese's, is a campaign office for Barack Obama. It has little business being there. Nebraskans have not voted for a Democratic presidential candidate since 1964. Statewide polls give John McCain a lead of some 20 points. Nevertheless, Mr Obama has this office, two others and 15 paid staff in Omaha—all for one electoral vote.

Two states make America's confusing electoral system more so. Forty-eight states have a winner-take-all method of handing out electoral votes. In Nebraska and Maine the winner gets only two votes; the rest (three for Nebraska, two for Maine) go to the winner of each congressional district. Neither state has ever split its votes. This year may be different.

Maine is almost as blue as Nebraska is red. Yet the McCain campaign has put some resources there. Mr McCain has a chance of winning the snowmobile-loving, hockey-playing northern district. Todd "Iron Dog" Palin visited on October 11th and 12th. America's hockey mom held a rally a few days later.

In Nebraska the Obama campaign is targeting the second district, containing Omaha with its college students, blacks, Latinos, a range of industries and a local Democratic hero, Warren Buffett. In January Douglas County, which makes up most of the district, had 12,000 more Republicans than Democrats. Now Democrats outnumber Republicans by almost 4,000. Evie Zysman, a 98-year-old, has four Democratic signs in front of her home.

Hal Daub, Mr McCain's state chair, says Republicans are campaigning "the Nebraska way", meaning that Mr McCain has given the state no money or staff. "Barack Obama does not have a chance," insists David Bywater, the head of the Douglas County Republicans. "People in this district are pro-family, pro-life and pro-business." Still, Sarah Palin recently was in Omaha—presumably shoring up the vote.

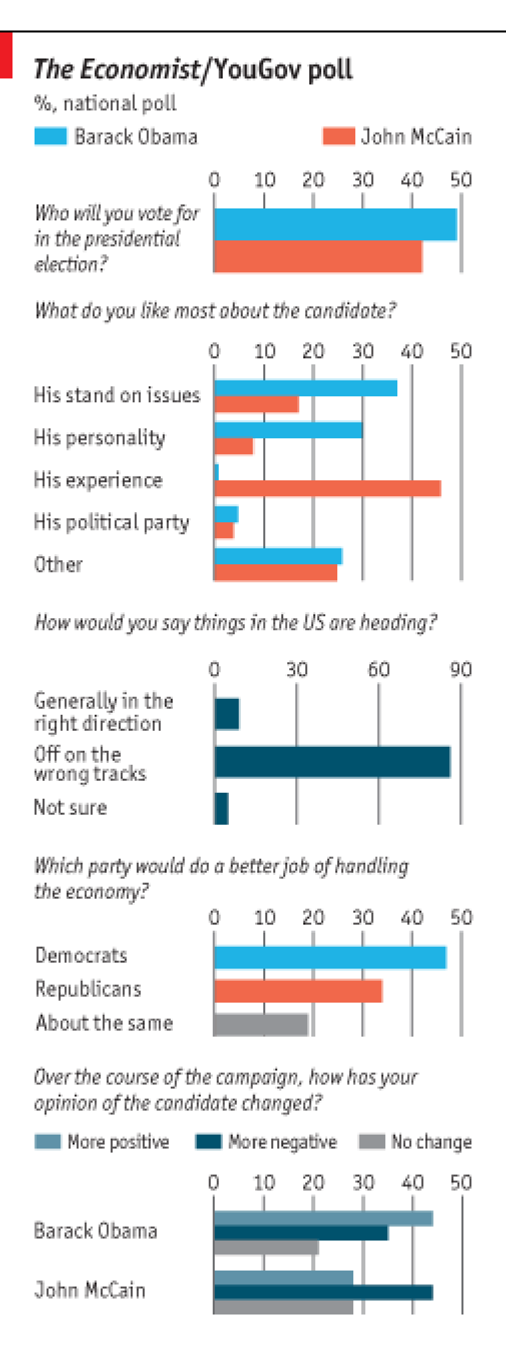


The Congress

A landslide looms

Oct 30th 2008 | DARIEN, CONNECTICUT AND LACONIA, NEW HAMPSHIRE
From The Economist print edition

Republicans warn of the perils of one-party rule



CHARGED with concealing $250,000-worth of gifts from a contractor, including a hideous statue of a fish, Senator Ted Stevens of Alaska opted for a quick trial to clear his name before election day. But he was found guilty this week. His career is over. And he is not the only Republican about to feel the voters' boot on his ignoble behind. The polls predict a Democratic landslide on both sides of Capitol Hill.

In the House of Representatives, the Democrats could increase their 36-seat majority by two dozen or so. In the Senate, where they have only a tenuous 51-49 advantage, and that only thanks to the support of two independents, they could win a commanding majority. They might even get to 60 seats, the magic number that strips the minority party of its power to use filibusters to block bills it objects to. Only two Democratic senators are likely to lose their seats: Barack Obama and Joe Biden. And if they win the White House, the governors of Illinois and Delaware will name Democrats to replace them.

Some voters think an all-Democratic Washington might be too much of a good thing. Too much power breeds extremism, as Americans discovered when Republicans ruled the roost between 2002 and 2006. Historically, one-party rule has also been fiscally profligate: presidents are slower to veto wasteful spending by their congressional allies.

What is more, although some of the bums about to be thrown out are indeed bums, the most embattled Republicans are typically moderates representing swing states or districts.

Consider Chris Shays of Connecticut's 4th district, one of the nation's richest. He is a free-trading social liberal who voted with President Bush less often last year than Hillary Clinton did. He has a number of pragmatic ideas, such as a "blue card" for illegal immigrants that would allow them to stay and work in America without letting them jump the queue for citizenship. In his ads, he claims to offer "the hopefulness of Obama" and "the straight talk of McCain". He is the last House Republican in New England, and he has a bull's-eye on his back.

The national Democratic Party is pouring money into ads that portray him as a Bush clone. Mr Shays responds by handing out an 88-page booklet describing his moderate record. Early one morning at a station in his district, he shakes hands and commiserates with all the Wall Street commuters who have lost a packet this year. Most are friendly. Some worry that Democrats will overtax the rich or overreach in regulating banks.

Some say they will vote both for Mr Shays and for Mr Obama. But others are upset about the Iraq war, which Mr Shays supported. Polls show him slightly behind his challenger, Jim Himes, a former banker. If people like Mr Shays lose their seats, the Republicans will become a more extreme party, and a less national one.

In the Senate, the stakes are even higher. Of the dozen senators facing tough races, only one is a Democrat—Mary Landrieu of Louisiana, and she is ahead in the polls. The Republicans, on the other hand, are in terrible shape. The Senate minority leader, Mitch McConnell of Kentucky, is struggling to defend his seat. Swing states such as Colorado and New Mexico are poised to reject Republican senators. Even red states such as Georgia and North Carolina might elect Democrats.

And Republican moderates are perhaps in even greater peril in the Senate than they are in the House. John Warner of Virginia is retiring, and almost certain to be replaced by a Democrat. Norm Coleman of Minnesota could lose to a comedian, Al Franken. Gordon Smith of Oregon is desperately trying to link himself to Mr Obama, and John Sununu of New Hampshire is in deep trouble.

If they thought the House was bad...

AP



Sunset for Sununu?

At a rotary club, Mr Sununu offers voters reasons not to sack him. As the only engineer in the lawyer-stuffed Senate, he says, he is good at solving problems. And he tried five years ago to curb the reckless loans that fuelled the housing bubble. Though a bit awkward on the stump, Mr Sununu is one of his party's most thoughtful lawmakers. He is a fiscal hawk, socially tolerant and less dogmatically pro-Israel than most other Republicans (he is of Lebanese descent). At 44, he is the youngest senator, and has been tipped for greater things. But his opponent, a former governor named Jeanne Shaheen, is no lightweight, and can piggyback on Mr Obama's mighty get-out-the-vote machine.

Mr Sununu gives warning that with a 60-seat majority in the Senate the Democrats could ram through tax increases and pass a batch of bad laws. For starters, they would abolish the right to a secret ballot before workers are unionised. They might also revive the "fairness doctrine", a rule that once forced radio stations to offer "balanced" political coverage or face lawsuits. Mr Obama says he does not support this idea, but congressional Democrats would love to shut down conservative talk radio, and Republicans doubt that Mr Obama would stop them.

For many conservatives, the most alarming consequence of a Democratic supermajority in the Senate is that it would allow a President Obama to appoint any judges he likes. With five of the nine Supreme Court justices over 70 and many seats on lower courts deliberately left vacant by the Democratic Senate in anticipation of a Democratic president, that could have far-reaching consequences.

Mr Obama might make good choices—his choice of advisers has usually been sound. But he has promised to pick judges for their "empathy" and "understanding" of "what it's like to be poor, or African-American, or gay, or disabled, or old." That could just be campaign blather, but conservatives fear he means it: that he really does want judges to favour the underdog rather than uphold the law dispassionately as their oath of office requires. Stephen Calabresi, a conservative jurist, says an Obama court could usher in ruinous shareholder lawsuits, huge punitive damages and even a constitutional right to welfare.

Democrats retort that if voters like Mr Obama's platform, which they seem to do at the moment, then electing a lot of Democrats to Congress will ensure that they get what they want faster. It is a fair point. But Mr Obama's most ambitious plans, such as reforming health care and curbing carbon emissions, will be hard to carry out without input and support from moderates in both parties. That was how Bill Clinton's welfare reforms and Ronald Reagan's Social Security reforms succeeded. By contrast, Hillary Clinton failed to deliver universal health care because she failed to build a cross-party consensus for it. With any luck, a President Obama would not make the same mistake.

The election campaign

Heard on the stump

Oct 30th 2008
From The Economist print edition

The best and worst of ’08

Worst makeover
“With all of the important issues facing the country right now, it’s remarkable that we’re spending time talking about pantsuits and blouses.”

$150,000 was spent on clothes for Sarah Palin and her family. A spokesman responded. Politico.com, October 22nd

Best Palin moment
“I love those hockey moms. You know, they say the difference between a hockey mom and a pit bull? Lipstick.”

Mrs Palin’s joke to the Republican convention, September 3rd

Worst Obama moment
“And it’s not surprising then they get bitter, they cling to guns or religion or antipathy to people who aren’t like them or anti-immigrant sentiment or anti-trade sentiment as a way to explain their frustrations.”

Barack Obama explained small-town Americans to San Franciscans. Huffington Post, April 6th 2008

Best Clinton moment
“Although we weren’t able to shatter that highest, hardest glass ceiling this time, thanks to you, it has about 18 million cracks in it and the light is shining through like never before.”

Hillary Clinton conceded defeat in the Democratic race on June 7th

Worst McCain moment
“I think—I’ll have my staff get to you. It’s condominiums where—I’ll have them get to you.”

John McCain was unsure how many houses he owned. Politico.com, August 21st

Best Freudian slip
“I love my wife and my five sons and their five wives. Wait a second. Let me clarify that. They each have one.”

Mitt Romney campaigning in New Hampshire, ABCNews.com, November 10th

Worst media moment
“My, I felt this thrill going up my leg. I mean, I don’t have that too often.”

Chris Matthews, a news anchor, summed up the media’s love for Mr Obama. MSNBC, *February 12th 2008*

Worst put-down
“I’m sorry, I don’t talk to the press and that applies to you, unfortunately. Even though I think you’re cute.”

Chelsea Clinton, campaigning for her mother, refused to be interviewed by journalists, even a nine-year-old reporter for Scholastic News. AP, December 31st, 2007

Best promise
"We promised them that we'll get a dog."

Mr Obama promised his daughters a pet if they have to move to Washington. Reuters, January 31st

Closing arguments

The end is nigh

Oct 30th 2008 | WASHINGTON, DC
From The Economist print edition

The candidates are making their final pitches to the electorate

“INFOMERCIALS” usually feature over-the-hill “actors” hawking improbable products in the small hours. Barack Obama’s infomercial on October 29th lasted for 30 minutes, appeared at 8pm on seven channels, including CBS and NBC, and featured state-of-the-art production techniques.

Mr Obama focused on bread-and-butter issues—the recent Wall Street crash (which he described as a verdict on eight years of failed economic policies from, guess who, the Republicans), rising health-care costs, home foreclosures, disappearing jobs and stagnating incomes—and he illustrated them by telling the story of various families he had met on the stump. He also tried to counter his airy-fairy image telling us, in as much detail as the format would permit, how he planned to deal with these problems.

This down-to-earth tone has been at the heart of his stump speech in the closing weeks of the campaign—a speech that has varied little no matter where it is delivered. But in both the infomercial and his stump speech Mr Obama is also reviving a theme from the early days of his campaign: the importance of changing the way that American politics works, reaching across the aisle to produce practical, rather than ideological, solutions to America’s problems. He somehow manages to combine this noble post-partisan argument with the distinctly partisan claim that John McCain is running for a third Bush term.

Mr Obama’s biggest problem in the final days of the campaign is overkill. The infomercial cost $5m (and cut into many people’s favourite television programmes, as well as cutting into the build-up to a World Series baseball game). Obama signs are ubiquitous and Obama ads are saturating the airwaves. In the battleground states, the Obama campaign is outspending the McCain one many times over. But the Obama team clearly thinks that overkill is a risk worth taking so long as they are driving their message home and keeping Mr McCain in the shadows.

For his part Mr McCain is also focusing on the economy. He lards every speech with references to Joe the Plumber and Mr Obama’s injunction to him that “we” need to spread the wealth around. Sarah Palin refers to “Barack the Wealth Spreader”. Mr McCain says that he is interested in creating wealth rather than spreading it around. Central to the McCain argument is that Mr Obama is nothing less than a “socialist”. If he could make that charge stick, it would hurt his rival, but perhaps not as much as he would like: many Americans are not unhappy with the idea of a bit of wealth-spreading these days.

In the final days of the campaign Mr McCain is emphasising his familiar strengths. He boasts of his record of getting things done in Washington, often on a bipartisan basis. He reminds people of his foreign policy and defence credentials (“I’m running to be commander-in-chief not redistributor-in-chief”). His campaign is also putting more emphasis than ever on the idea that Mr Obama is a risky choice: some McCain ads show tanks, stormy seas and Islamic extremists.

But Mr McCain is having a hard job making himself heard over the noise of the Obama machine: last week Mr Obama spent $21m on ads, twice as much as his rival. This is forcing Mr McCain to rely more and more on a closing argument he would rather not be making: that he is an underdog who will prove all the pundits and pollsters wrong.



Ohio

On the eve of battle

Oct 30th 2008 | CLEVELAND
From The Economist print edition

We revisit our first swing state



WITH a week to go till election day, Barack Obama and John McCain were both stumping around Ohio this week: and no wonder. Along with Missouri, Ohio is reckoned to be the best of bellwethers, the most reliable predictor of the national result; and its Republicans are mostly pretty gloomy.

One senior party man lowers his voice and confides: “I hate to say this, it’s a terrible thing, but the only thing that might save us is people’s reluctance to vote for Obama because of, you know, his colour.” Another senior local official, out in rural Appalachia, brightens for a moment when Mitt Romney, the multimillionaire businessman whom Mr McCain defeated for the nomination back in February, appears on a television screen: “If we’d picked that guy, we wouldn’t be in the position that we are in.” There is widespread support for Sarah Palin among these Ohio Republican bosses—but mainly because she has galvanised the party base and made it easier for them to get volunteers to turn out and man the phone banks or hand out flyers, not because they really think she can help them win. Before Mrs Palin was put on the ticket, another activist explains, it was hard to get anyone to turn up.

This is hardly surprising: Ohio feels like a lost cause this year. In 2004 George Bush won the state by a mere 118,600 votes. And that was before the economy turned sour, and before the Democrats booted the Republicans from the governor’s mansion at the 2006 mid-terms. This year the Democrats are in far better shape than they were in 2004. Chris Redfern, who chairs the Democratic Party in Ohio, says the campaign has an office in every one of Ohio’s 88 counties this year, rather than the 16 they had in 2004.

This enables the Democrats to fight a three-pronged campaign. First, they plan to maximise turnout and vote share in their base territory, the 16 counties they won in 2004, most of them located in or around big cities, or in university towns. The second objective is to add a few counties to their tally, and for this they are mostly targeting suburban counties like Licking and Delaware, close to Columbus, the state capital, and around Ohio’s other main cities: Cleveland, Toledo, Cincinnati, Dayton, Akron and Canton. And the third prong of the attack is to fight the Republicans to a standstill in the rest of the state, especially in the Appalachian east and south-east, which is politically a finely-balanced mix of hilly agricultural land and the depressed mill-towns that are dotted along the Ohio river.

The city strategy is likely to bear the most fruit. And may work best in Cleveland—Ohio's second largest city, but also one of America's most economically challenged, thanks to the decline of its steel and car industries. Cleveland has a population of about 440,000; half what it was in 1950. But slightly more than half of those people are black, and the Obama campaign has been working hard at registering them to vote and at turning them out. Colleen Day, director of the Cuyahoga County Democrats (Cuyahoga contains Cleveland), says, doubtless with a touch of exaggeration, that her county is where Ohio, and maybe the whole election, will be won for Mr Obama. As evidence she points out that African-American voter turnout has usually been very low in Cleveland, at only about 25%: this time, thanks to the Democrats' efforts, more than this proportion had already voted by mid-October. Getting more voting machines into crowded inner-city precincts will help a lot too.

The Appalachian strategy is ambitious in a different way. It involves opening offices in places where Democratic presidential candidates don't normally campaign, and organising hard. Daniel Elefant, for instance, has come all the way from California to run an Obama office in the small river town of Bellaire. But the response, he says, has been gratifying. Granted, this is a bleak old union town, its streets almost deserted, its sad Toy Museum shuttered and abandoned. But quite a few of the Obama volunteers there are ex-Republicans.

Up-river, it is a similar story. Columbiana County is a bit more prosperous; it voted for Mr Bush last time. But drive around once-wealthy Salem, and everywhere you see disused factories. Even some of the Republican volunteers are working two jobs to make ends meet. Old family firms are cutting back, and going under. Appalachia feels like it is shifting leftward.

Governors in trouble

The other executives

Oct 30th 2008 | NOBLESVILLE, INDIANA
From The Economist print edition

Gubernatorial candidates are waging their own battles

POLITICS does not favour subtlety. Parked outside a recent rally for Sarah Palin in Indiana was a giant mobile home, decorated with hundreds of signatures and “My Man Mitch” in big letters. Mitch Daniels, Indiana’s governor, is running for re-election. The vehicle was there to remind Mrs Palin’s supporters (20,000 of them), that the presidential race is not the year’s only contest.

Beneath the furore of the presidential campaign are a handful of heated contests for governor. There are now 28 Democratic governors and 22 Republican ones. This year has only 11 races, but the Republican Governors Association and Democratic Governors Association have each broken their fund-raising records.

In seven of the states—North Dakota, Utah, Vermont, New Hampshire, West Virginia, Delaware and Montana—the reigning party looks set to keep the governor’s office. In Indiana, Mr Daniels faced an improbable challenge from an underfunded Democrat, but now seems certain to defeat her. The three states most likely to see upsets are Missouri, North Carolina and Washington. The presidential campaign has had an effect on the local ones. Missouri and North Carolina are, after all, swing states. But each governor’s race is also its own battlefield.

In Missouri, where Mr McCain and Mr Obama are tied in the polls, the Republican candidate never had a chance. Matt Blunt, the Republican governor, announced in January that he would not seek re-election. He explained, “we have achieved virtually everything I set out to accomplish”; his accomplishments include a 33% approval rating in 2006. Jay Nixon, the Democratic nominee and Missouri’s well-known attorney-general, has hammered Republicans for cutting Medicaid enrolment and letting the state’s unemployment rate rise to a 17-year high. After a bruising primary Kenny Hulshof, a congressman, emerged as the Republican candidate. Mr Nixon says Mr Hulshof has “embraced the failed policies” of Mr Blunt and George Bush. The Democrat leads by 14 points, according to the most recent poll.

Much closer are the races in North Carolina and Washington, and here Mr Obama’s message of change is doing Democrats no favours. North Carolina has a term-limited Democratic governor; Washington has a Democratic governor seeking re-election. Beverly Perdue, North Carolina’s lieutenant-governor, and Pat McCrory, the Republican mayor of Charlotte, are squabbling over issues as broad as the economy and as local as public safety and whether North Carolina should take other states’ rubbish. But arching over such fights is Mr McCrory’s effort to cast Ms Perdue as part of the status quo—a favourite catchphrase is “It’s time for a change”. The two are in a dead heat.

Washington is seeing a re-enactment of its nasty election of four years ago, when Christine Gregoire beat Dino Rossi, the Republican, by only 133 votes. Lingering grudges and a weakened economy—Washington faces a $3.2 billion budget shortfall—make Ms Gregoire more vulnerable. In this blue state, Mr Rossi presents himself as bipartisan. He appears on the ballot not as a Republican but as a member of the GOP, a ruse that apparently confuses some voters. On the night of Mr Obama’s convention speech, Mr Rossi ran an ad about working across party lines “to change our Washington for the better”. He and Ms Gregoire continue to run neck and neck.

These fights are a hint of what is in store. In 2010 there will be 36 gubernatorial races. The DGA and the RGA each have strategies to ensure they win most. Those in power after the 2010 Census will have enormous clout: they, together with the local legislatures, will be in charge of redrawing the boundaries of congressional districts. This election may at last be almost over, but the Republican backlash is already brewing.

Proposition 8

Showdown

Oct 30th 2008 | LOS ANGELES
From The Economist print edition

California's fight over gay marriage hints at changes in the culture wars

AP



Protection or discrimination?

A COLOURFUL crowd gathered in the car park of a Catholic church in south Los Angeles on October 24th. There were suburban white evangelicals, blacks, Asians and Hispanics. Many pushed prams. People ate tacos and listened to Marvin Perkins, a black Mormon, invoke the memory of Martin Luther King. The aim of this rainbow coalition? To remove a basic right from another minority group.

The hardest-fought political race in California is not the presidential one, which will surely be a big win for Barack Obama. It is over a ballot initiative, Proposition 8, which would rewrite California's constitution so as to define marriage as a union between a man and a woman. Supporters and opponents see California, where gay marriage has been legal since a court ruling came into effect in June, rather as the second world war allies saw Berlin. Money is pouring into the race. At least $70m has been raised so far—more than for all other campaigns to ban same-sex marriage put together.

The race is expected to be extremely close. Although the most recent poll by the Public Policy Institute of California puts opponents of the ban eight points ahead, this appears to be an issue on which people routinely lie to pollsters. Supporters of the initiative are much more fired up than opponents. And Mr Obama's candidacy is likely to generate a huge turnout among blacks, who oppose same-sex marriage more firmly than any other ethnic group.

Proposition 8's supporters have assembled an extraordinarily broad coalition. Although much of the campaign's ideological heat comes from evangelicals, much of its money comes from Mormons. More donations to Protectmarriage.com, the initiative's chief proponent, have come from Utah than from any other state except California. Orthodox Jewish synagogues have weighed in, too. It is an unusual movement indeed that unifies blacks, Mormons and orthodox Jews. It hints at how cultural conservatives might evolve to meet the challenge of an unfavourable Washington political climate in the next few years.

Another striking feature of the campaign is its pitch for victim status. It is a measure of how freely gays and lesbians have moved into mainstream society, at least in California, that those who seek to remove their right to marry are complaining about persecution. Their television advertisements focus on the threat to children—who, they claim, will be forced to learn about gay relationships if Proposition 8 fails. They claim that supporters have been subjected to violence. The issue, they say, is not one of civil rights but of religious freedom.

At least, that is the message in their TV adverts. At the rally in Los Angeles, the message was blunter. Mr

Perkins informed the crowd that gay marriage and tolerant school lessons are little more than “a recruiting process for homosexual behaviour”. Anybody who doubted the connection should take a look at Europe, where homosexuality is apparently rampant.

Lexington

Two cheers for American democracy

Oct 30th 2008
From The Economist print edition

A good way to pick a president

Illustration by KAL



THERE is nothing else like it on earth. No other country obliges its future leaders to spend two years on the campaign trail. No other country forces them to conjure hundreds of millions of dollars out of thin air. And no other country gives make-or-break power to people in plaid shirts in out-of-the-way places.

America's bizarre process for electing its president inevitably raises questions. Why should Iowa and New Hampshire be given such unusual power? Doesn't all that money corrupt politics? Doesn't the sheer length of the campaign encourage people to fixate on trivia (with just a few days to go, the current obsession is Sarah Palin's $150,000 wardrobe)? Serious people complain that the nature of the campaign discourages other serious people from running. They also worry that the campaign leaves the next president not so much ready on day one as utterly exhausted.

But this year both sides fielded a long list of impressive candidates: political superstars such as Hillary Clinton and Rudy Giuliani, experienced governors such as Mitt Romney and Bill Richardson, leading senators such as Sam Brownback and Chris Dodd. There were also plenty of unconventional candidates, from Dennis Kucinich on the tin-foil-hat left to Mike Huckabee on the down-with-Darwin right. Alan Keyes, perhaps the most unconventional of the lot, is still running as an independent, as is the perennial Ralph Nader.

This election cycle has undermined some of the familiar complaints about the election system. The main complaint about Iowa and New Hampshire is that they are white states in an increasingly diverse country. But Iowa happily voted for Barack Obama. The main complaint about the money race is that it gives too much power to established candidates and their rich friends. But Mr Obama defeated the Clinton machine primarily by raising small contributions over the internet. Mr Romney fell by the wayside despite the fact that he spent $45m of his own money. And Ron Paul remained in the Republican race for months because of his astonishing ability to raise small sums of money from his fellow libertarians.

There is even something to be said for the length of the campaign. Two years of campaigning allows the candidates to get to know a sprawling country of 300m people. People who spend most of their lives in Washington or state capitals are forced to hopscotch from sea to shining sea. Two years of campaigning also gives "losers" a chance to recover and voters a chance to change their minds. Mrs Clinton made up for her defeat in Iowa with a victory in New Hampshire, and gave Mr Obama a run for his money in a

swathe of blue-collar states. John McCain returned from the grave to capture the nomination from better-funded rivals.

The complicated obstacle course is about as good a test of a potential president's character as you can devise. It tests a wide range of qualities—from debating on television to pressing the flesh in Iowa to giving big speeches. It measures your ability to deal with the unexpected as well as your ability to stay on message. The race is a test of will and endurance that quickly weeds out the weak. It also demands that the winner create and run a nationwide organisation.

The obstacle course does an efficient job of eliminating candidates who only have one strength, such as organisation, in Mr Romney's case, or Senate experience, in Mr Dodd's. Mr Obama's critics argued that he was only good at giving "pretty speeches". But the reason that he is the clear favourite is that he has such a wide range of strengths. He has created the most innovative machine in recent political history. He has produced detailed policy proposals on everything from health insurance to Russia (he has a brain-bank of 200 foreign-policy experts). He has displayed grace under pressure when confronted with everything from Jeremiah Wright's anti-American rants to the Wall Street meltdown. Mr Obama is a decathlete not a one-trick pony.

The voice of the people

But the best thing that can be said for the system is that it is so democratic. In most countries party leaders are chosen by political insiders. In America rank-and-file party members (and some independents) get to choose—and this year they upset all political calculations by rejecting the inevitable Mrs Clinton on the left and choosing the maverick Mr McCain on the right.

Millions of people have been enthused by the campaigns on both sides. On October 26th 100,000 people in Denver, Colorado, endured cold weather and time-consuming security checks to see Mr Obama. Mr McCain and (particularly) Mrs Palin have also attracted boisterous crowds. More people than ever before have given money to one candidate or another—and unprecedented numbers will take part in get-out-the-vote efforts on election day. All the signs are that this will be the third presidential election in a row where turnout has gone up rather than down.

There are plenty of reasons to withhold the final cheer. The candidates spend too much time repeating their stump speeches and not enough wrestling with tough questions (the Obama campaign's aloof way with the press is particularly inauspicious). But the biggest problem is perhaps that the process is too enthralling. Americans have spent the past two years in a state of obsession with their presidential campaign. Even important global events such as Russia's invasion of Georgia have been seen through that prism.

But for all that Americans can at least take some comfort, during these glum times, over the state of their democracy, at least on the presidential level. The system may be time-consuming and money-grubbing. But it has allowed the son of a couple of nobodies, who was denied a floor pass to the Democratic Convention eight years ago, to become, by dint of sheer charisma and organisational skill, the probable president of the country.

Mexico

Spot the drug trafficker

Oct 30th 2008 | MEXICO CITY
From The Economist print edition

The arrest of senior officials shows the government's resolve in fighting drug traffickers—and that the rot in law enforcement reaches the top

Reuters



AT LAST the government seemed to be enjoying some success in its battle against the drug gangs. On October 25th Eduardo Arellano Félix, a leader of the Tijuana "cartel", was arrested, the last of five brothers still at large who had run what was once one of the world's most powerful trafficking syndicates. Tijuana has been the scene of a vicious battle between drug factions and the security forces, with over 150 murders in the past month alone. Mr Arellano (pictured above) was captured by Mexican officials acting on information from the United States' Drug Enforcement Administration (DEA) and the US Marshals Service. It was an example of the kind of co-operation that officials in both countries hope will bring success for the crackdown against the drug gangs launched by Felipe Calderón when he took office as Mexico's president almost two years ago.

But only two days later came news of more worrying recent arrests, those of two top officials at the attorney-general's office who were among those supposedly leading the crackdown. Miguel Colorado González was in charge of assigning police to organised-crime investigations; Fernando Rivera Hernández was one of his deputies, in charge of intelligence. Three more junior officials were also indicted, and 30 were fired pending further investigation. According to investigators, the arrested officials had been passing information to the Sinaloa cartel, a more powerful rival to the Tijuana mob. They had received up to $450,000 a month in bribes, in some cases going back several years.

In a brief reference, Mr Calderón said the arrests were evidence of the government's seriousness in fighting crime. But if the allegations are true, they show that the rot in Mexican law-enforcement reaches right to the top. They also reveal a failure to carry out basic checks on the personal finances of senior officials.

Over the past two decades Mexico's drug mobs have accumulated enormous firepower and wealth, and corrupted local police forces and politicians, especially along the northern border with the United States. Mr Calderón has unleashed the army and the federal police against them, in an attempt to "recover public space" from the traffickers. This strategy hinges on the notion that federal institutions are less corrupt than their local counterparts.

That assumption has now been called into question. In 1997 an army general named as Mexico's top anti-drug official was found to be working for the traffickers. But since Vicente Fox won a presidential

election in 2000, ending seven decades of rule by the Institutional Revolutionary Party, Mexican governments have attempted to put a long history of corruption behind them. Several senior federal police commanders have been murdered in the past year, presumably because Mr Calderón's crackdown has hurt the traffickers (or some of them, at least).

The other assumption of Mr Calderón's strategy was that the army would be deployed temporarily while more police were recruited and trained for an expanded federal force. But progress has been slow, and there are fears that the army is being corrupted. "We may end up without trustworthy police and without a trustworthy army," says Guillermo Zepeda of CIDAC, a think-tank in Mexico City. A reform of the penal code earlier this year increased police powers, giving them the right to detain suspects for up to 80 days without charge. Some worry that without better oversight that will lead to abuses.

At least 4,000 people have been murdered in violence involving traffickers so far this year. Officials say that is a sign that government pressure is having an effect. Some believe that the Sinaloa mob has been least affected by the crackdown. Nevertheless, one of its leaders, Jesús Zambada (aka "the king"), was among 16 of the gang's members (including three policemen) arrested last month after a gun battle. The authorities say that since December 2006 they have arrested more than 48,000 traffickers, seizing 69 tonnes of cocaine and more than 24,000 illegal firearms.

Mexican officials point out that many of those weapons are bought at gun shops just over the border in the United States. Nevertheless, under Mr Calderón Mexican and American officials have co-operated more closely than ever. A year ago, George Bush asked Congress for an "urgent" $400m in anti-drug aid for Mexico, to supply helicopters, surveillance kit and training. After months of debate, Congress approved the request but the money has yet to be disbursed. It will be "soon", promised Condoleezza Rice, the secretary of state, on a visit to Mexico last month intended to show support for Mr Calderón's battle against the traffickers.

The arrests at the attorney-general's office may damage this growing trust. But it is not only the Mexican government that has been penetrated. A Mexican working for the DEA at the American embassy in Mexico City was also passing information to the Sinaloa mob, according to Mexican officials. American officials have asked for the extradition of Mr Colorado González, and will probably get it.

"We are on the right path" in the battle with the traffickers, Eduardo Medina Mora, the attorney-general, insisted this week. The government has ramped up spending on the treatment of drug addicts and on education campaigns—a recognition that drug consumption is now a big problem in Mexico as well as the United States. After years of complacency, tackling the trafficking gangs was never going to be easy. But almost two years into the battle, most Mexicans feel less rather than more secure.

Chile

The writing on the wall

Oct 30th 2008 | SANTIAGO
From The Economist print edition

And it points to the right

AP



A dress rehearsal for the presidency

MUCH as some of them tried to claim the result was a victory of sorts, the dejected faces of the leaders of Chile's governing centre-left Concertación coalition on the night of October 26th told a different story. In that day's municipal elections, Alliance, the centre-right opposition, won 41% of the vote for mayors, two percentage points more than the Concertación but enough to win eight of the 14 regional capitals. It was the first-ever defeat in a nationwide election for the Concertación, which has ruled Chile ever since the end of General Augusto Pinochet's dictatorship in 1990. Jubilant Alliance leaders reckon that the result paves the way for them to win the presidency in an election in December next year—and to counter South America's recent drift to the left.

The victory was not clear-cut. Confusingly, municipal councillors are elected separately. In that ballot the Concertación, which includes the Socialist and Christian Democrat parties, won 45% of the total vote to 36% for the Alliance. But more people (some 10% more) voted for mayors than for councillors. The overall result confirmed opinion polls that make Sebastián Piñera, a wealthy businessman and the Alliance's putative candidate, the front-runner for the presidency.

Voters punished the Concertación because it is tired, increasingly ineffective and fractious. It has presided over the consolidation of Chile's democracy, almost two decades of economic growth and stability, and much social progress. But under Michelle Bachelet, the president since 2006, it has run out of steam. It has failed to promote new, younger leaders. A spate of corruption scandals, though mostly minor, has left even some Concertación supporters wondering whether 20 years in office might not be enough. Chile's economy may be stronger than that of many of its neighbours, but it no longer grows at Asian rates, and inflation has spiked this year. A botched attempt to modernise public transport in Santiago, the capital, smacked of incompetence.

But if voters are tiring of the Concertación, opinion polls suggest they are not thrilled by the Alliance. The voting system, bequeathed by General Pinochet, divides the country into two-member constituencies, thus cementing a two-coalition system and punishing third parties. This has produced political stability but is widely blamed for apathy. Nevertheless, in the municipal election a new force formed mainly by defectors from the Christian Democrats won 7.6% of the vote, while a far-left coalition got 9.1%.

Ms Bachelet this week called on the Concertación to show "unity, unity and more unity". She also called for an electoral pact with the far left—which would push Christian Democrat voters towards Mr Piñera. She has presided over unprecedented infighting among the Concertación's four parties. Since presidents cannot serve consecutive terms, the coalition must now try to unite behind a successor to Ms Bachelet, decide how to choose one and agree a programme. There are three strong contenders: Ricardo Lagos, a former president, is Chile's most popular politician; the stolid Eduardo Frei, another ex-president, might appeal to the centre; José Miguel Insulza, the secretary-general of the Organisation of American States, has said that he would stand only if the Concertación fields a single candidate.

Chileans have not elected a government of the right for half a century. Mr Piñera's victory is not assured. But Alliance has taken the first step. As the economy slows along with the world's, the government will start to spend some of the windfall copper revenues it has saved. But many of the mayors implementing job-creation schemes will now be from the opposition, and they will doubtless claim the credit for them. No wonder the Concertación looked so glum on election night.

Upping the body count

Oct 30th 2008 | BOGOTÁ
From The Economist print edition

Not that hard, when any body will do

IT IS the kind of outrage that Colombians hoped belonged to the past rather than the present. Over the course of this year, a score of unemployed young men disappeared from their homes in Soacha, a poor suburb of Bogotá, only to turn up dead, apparently killed in combat by the army, several hundred miles farther north. There was speculation that they had been offered jobs by paramilitary groups. But as investigations have proceeded, the truth turns out to be even worse. The young men appear to have been kidnapped, turned over to army units and then murdered in order to inflate the body count of dead guerrillas.

After three army colonels were dismissed over the case, President Álvaro Uribe and his defence minister, Juan Manuel Santos, took more drastic action on October 29th. They announced the firing of three generals and 24 other officers or NCOs, in the biggest purge of the army for a decade. A military investigation had found that “in some parts of the army there has been negligence”, Mr Uribe said. “There may be members of the armed forces involved in murder.” The government has ordered the attorney-general’s office to investigate, and officials say that any officers who are charged will be tried by civilian, not military, courts.

Worryingly, the case of the Soacha youths may not be an isolated one. There have been reports of similar disappearances of young men in two other parts of the country. In a report released this week, Amnesty International, a human-rights group, says that the security forces were responsible for 330 “extrajudicial executions” last year, up from an average of 220 a year in 2004-06. Amnesty says paramilitaries killed around 300 civilians last year and guerrillas about 260. The government’s own watchdog is investigating 930 suspected killings by the army.

Officials argue that overall levels of violence have fallen steadily over the past decade, as a result of the demobilisation of many of the right-wing paramilitary groups and the army’s success against the FARC guerrillas of the left. The government has been shaken by previous reports of army units killing civilians and passing them off as dead guerrillas. Last year the defence ministry adopted a new policy that measures the army’s success by the number of guerrilla captures or desertions, rather than the body count. In firing the generals commanding two divisions where abuses occurred, the defence ministry appears to be sending a message that it will hold commanders responsible for ensuring that the new policy is carried out.

The purge follows two other recent cases in which Mr Uribe has been embarrassed by the actions of his subordinates. The government was forced to order an investigation over a video aired on CNN which showed that, contrary to their denials, police opened fire on thousands of Indian marchers demanding land, killing two protesters. And the director of intelligence resigned after it was revealed that a mid-level official in her agency had spied on Gustavo Petro, an opposition senator.

The only good news for the security forces was the escape of Óscar Tulio Lizcano, a former senator who had been held as a hostage for eight years by the FARC. Several months ago the army identified the camp in the jungles of western Colombia where he was held. Troops surrounded the camp, cutting off supplies. The guerrilla commander guarding Mr Lizcano opted to desert, taking his hostage with him. The military operations which achieved this happy ending were “an honour for the Colombian armed forces”, Mr Uribe declared. Sadly, that honour appears to have been tarnished by the murder of innocent civilians elsewhere in the country.

Central America

Zelaya plays the Chávez card

Oct 30th 2008 | TEGUCIGALPA
From The Economist print edition

Why Honduras wanted 4m light bulbs


Reuters

USED as a jumping off point by the CIA for regime-change efforts in Guatemala in the 1950s and Nicaragua in the 1980s, Honduras, a small Central American country, has always been a firm ally of the United States. So it came as something of a shock when Manuel Zelaya, the president, recently signed up to the Bolivarian Alternative for the Americas (ALBA in Spanish), the anti-American alliance led by Venezuela's Hugo Chávez (the two are pictured). That decision was ratified last month by Honduras's Congress. Small as Honduras is, its adherence is something of a coup for Mr Chávez, since ALBA has hitherto been a select club, comprising only Bolivia, Cuba, Dominica and Nicaragua, apart from Venezuela.

Mr Zelaya's motives seem clear enough. After growing at 6% for several years, the economy has slowed this year because of the problems in the United States, its main export market and source of both tourists and remittances. The trade deficit has widened and food and fuel price rises have pushed up inflation.

Earlier this year Honduras joined Petrocaribe, a broader programme in which Venezuela subsidises oil shipments to 18 countries around the Caribbean basin. Now, in return for joining ALBA, Venezuela has offered to buy Honduran bonds worth $100m, whose proceeds will be spent on housing for the poor. Mr Chávez has also offered a $30m credit line for farming, 100 tractors, and 4m low-energy light bulbs (Cuba will send technicians to help to install them, as well as more doctors and literacy teachers.) Under a vaguer clause in the pact, Honduras is ceding the right to look for oil to an ALBA-run company.

Just what else Mr Zelaya might have agreed to is unclear, even to some government officials. Many ordinary Hondurans seem uncertain as to the benefits of ALBA. A recent poll found a sharp fall in Mr Zelaya's approval rating, to just 25%. The opposition abstained when Congress voted on the alliance.

Mr Zelaya's vice-president, Elvin Santos, insists that ALBA will have "no influence on internal politics". Officials say that they still want good relations with the United States. That message is reinforced by Enrique Flores Lanza, an adviser to Mr Zelaya. He says that Honduras is the first "non-aligned" member of ALBA. Nevertheless, when Bolivia and Venezuela expelled the American ambassadors in their countries in September, Mr Zelaya duly mimicked them by refusing to agree to the arrival of a new ambassador. But he quickly reversed that decision.

Mr Santos accuses the United States of being "indifferent" to the problems of Honduras. In fact, it gave economic aid of $37m last year. It recently renewed a rule under which 75,000 Hondurans who migrated to the United States after Hurricane Mitch in 1998 can stay there.

In addition, Honduras was the first country in the Americas to sign an agreement for additional aid from the Millennium Challenge Account, a foreign-aid scheme set up by Mr Bush. Under this programme, the United States agreed to spend $215m in Honduras over five years, improving roads and helping farmers. But continued disbursement of this money has been thrown into doubt because American officials have adjudged Honduras to have made insufficient effort to eliminate corruption. Mr Chávez attaches no such conditions to his largesse.

Helmis Cárdenas, a political analyst in Tegucigalpa, the capital, reckons Mr Zelaya's decision to ally so closely with Mr Chávez was the personal whim of a sometimes impulsive and high-handed president. He does not think Honduras will remain a member of ALBA, after a presidential election next year, whoever

wins it.

By joining Mr Chávez's block, Mr Zelaya has sent a timely message to the next American president that he cannot take the loyalty of Central America, a largely impoverished region troubled by organised crime and natural disasters, for granted. But on the other hand, as the oil price falls, Mr Chávez's appeal as an ally may swiftly diminish—even if those light bulbs prove to have a lasting benefit in reducing energy consumption.

The credit crunch

China moves to centre stage

Oct 30th 2008 | BEIJING
From The Economist print edition

In a whirl of financial summitry, China ponders how to wield its new-found clout

EPA



"WE SWIM together, or we sink together," said the European Commission's president, José Manuel Barroso, as Asian and European leaders gathered in Beijing for a summit on October 24th and 25th that was dominated by the global financial crisis. But China, proclaiming itself relatively unscathed, is in no rush to act.

The crisis is pushing the world's fourth-largest economy, with the biggest foreign-exchange reserves, to the centre of global summitry. The prime minister, Wen Jiabao, has said China will "actively participate" in a meeting of world leaders called by George Bush to discuss the issue on November 15th. After the Asia-Europe meeting, or ASEM, Mr Wen headed to Russia and Kazakhstan, venue for a pow-wow of Central Asian leaders, for more talks with global finance at the forefront.

But for all its avowed confidence in its own future ("the impact is limited and controllable," said Mr Wen), and its hinted aspirations for a world financial order less dominated by America and its dollar, China does not want to throw its weight around. At ASEM, the seventh such biennial gathering since 1996, China echoed Mr Barroso's calls for concerted international action. But it had few ideas to offer on what this should involve. More regulation of the international financial system, Mr Wen unadventurously proposed.

The most concrete idea discussed by the Asian countries at ASEM was to set up an $80 billion fund by the middle of 2009 to help countries in the region deal with liquidity problems—a plan already agreed in May. The bulk of the money would come from China, Japan and South Korea, but details of how much each would contribute and how the fund would be managed have yet to be announced.

For China, with $1.9 trillion in reserves, and Japan, with nearly $1 trillion, the proposed amount is hardly massive. But the countries giving most are likely to wield most clout. The participating countries, which also include the ten members of the Association of South-East Asian Nations, are a fractious lot and have differing views, not least over the roles of China and Japan in Asia. Most of them are still far too touchy about sovereignty to agree on any meaningful pooling of it.

Chinese leaders told ASEM that their priority was to keep their own economy running smoothly. This, said Mr Wen, was China's "greatest contribution to the world". China's economic growth has recently slowed, unusually, to a single-digit rate (9% in the third quarter) and many economists expect it to remain that

way next year. But its buoyancy is a solace to Asian countries, several of which enjoy trade surpluses with China, and to the European Union, for which China is the fastest-growing market—albeit, as the Europeans like to point out when they complain about Chinese trade barriers, still no bigger than Switzerland. At least European moans about successive years of the yuan's depreciation against the euro, making European exports costlier, have now been silenced by a reversal of the trend.

China seemed reluctant at first to let the financial crisis dominate ASEM's agenda. But it lost nothing by doing so. It deflected attention from climate change, another big issue of concern. The Europeans want China to make stronger commitments to cut its carbon emissions. But if there were concerns at ASEM about backsliding by China as it focuses more on boosting growth and employment, participants were too well-mannered to raise them publicly (just as they were all far too tactful to complain that Taiwan, Asia's fifth-biggest economy, is not even represented at ASEM because of China's objections).

A shared sense of crisis also gave China a face-saving way of engaging in some fence-mending. Germany's chancellor, Angela Merkel, who had riled the Chinese by meeting the Dalai Lama in September last year, was told by President Hu Jintao during a meeting on the sidelines that China's relations with Germany were "good".

That is as far as a Chinese leader will ever go towards saying that all is forgiven. Japan's new prime minister, Taro Aso, was also cordially received despite his China-sceptical views, and despite his just having signed a security pact with India, which some at least in China will see as directed against their country. Japan and China agreed to set up a hotline. China and Vietnam agreed to finish marking their contentious land border by the end of the year.

But while China relishes the attention it commands at such gatherings, it is resisting the temptation to swagger in its dealings with America. There are concessions China would like. One would be an end to America's de facto power of veto in the IMF. Recently it has been showing its pique at this by blocking publication of an IMF report examining whether China has been manipulating its exchange rate for the sake of trade advantage. A Chinese newspaper said America must give up its control over the IMF in return for China's helping out in the crisis. But the government has not gone that far in public.

In Russia, with whose leaders China shares strong misgivings about America, Mr Wen did allow himself to say that developing countries should have a stronger say in a new financial system. He also said there was a need to "diversify" the global currency system, a tactful way of saying the dollar's sway should diminish. But ASEM's closing statement said the IMF should play a critical role in helping badly-hit countries. Its only caution was that this should be "upon their request".

Albert Keidel of the Carnegie Endowment for International Peace, a Washington think-tank, says China does not want "to be seen as a problem for existing powers" at this stage of its economic development. But he also argued in a recent paper that there could be trouble ahead as recession in the West, which he believes China could ride out, stokes protectionist demands. The crisis could also result in China's economy surpassing America's earlier than expected—well before 2030, Mr Keidel suggests. Hard as Chinese diplomats try to wear a friendly face, this would be a psychological jolt for Americans.

Online activism in China

Murder and theft

Oct 30th 2008 | BEIJING
From The Economist print edition

Less heinous when the victims are the police, and Microsoft?

AFP



Where an unlicensed bike ride can lead

A CHINESE man who killed six unarmed police officers in Shanghai can hardly be surprised to find himself on death row. But he might be taken aback by the popular sympathy for his plight. So might the authorities: the case has become an embarrassment.

On October 20th Shanghai's high court upheld the death sentence imposed in September on Yang Jia, an unemployed 28-year-old from Beijing. China's Supreme Court is now deciding whether the execution—normally with a bullet through the back of the head—should go ahead. Officials say that in the first half of this year it overturned 15% of death sentences. But police-killers are unlikely candidates for reprieve.

Even for less egregious crimes public support for the death penalty is widespread, as China often points out when justifying its frequent use of executions (more than the rest of the world combined). But contempt for the police is just as common. After storming into a police station on July 1st and stabbing six officers to death and injuring three others and a security guard, Mr Yang was shown remarkable understanding by China's voluble internet users. Dozens of supporters gathered outside the Shanghai courthouse during the latest hearing. The police dispersed some who wore T-shirts adorned with his photograph.

Mr Yang's standing was bolstered by internet rumours—denied by the police—that he was beaten up by officers when he was detained last year for riding an unlicensed bicycle. Many also criticised the secrecy in which the first trial was held and an apparent conflict of interest: Mr Yang's lawyer was giving advice to the local government responsible for the murdered policemen.

The Chinese authorities are sensitive to online complaints. This week tens of thousands of Chinese have signed online petitions denouncing Microsoft for sending code to users of pirated Windows software that turns the desktop backgrounds on their screens black. China has been trumpeting its progress in protecting intellectual-property rights. But in the face of the internet outcry and threatened lawsuits against Microsoft, a senior Chinese copyright official gently rebuked the firm: "Measures for safeguarding rights also need to be appropriate."

At Mr Yang's high-court appeal the authorities gave in to demands for press access (though not by foreign reporters) and allowed Mr Yang to use a different lawyer. But criticising an American company comes easier than deferring to critics of the police. Chinese websites have removed many postings defending Mr Yang. Xinhua, the state-run news agency, said law experts had "lined up" in support of his execution. Mr Yang is unlikely to have to wait long.



WORLD
ASIA

Taiwan

Cross straits

Oct 30th 2008 | TAIPEI
From The Economist print edition

Angry with the president—and China



Reuters

Hardly a welcome party

SINCE the inauguration in May of President Ma Ying-jeou, Taiwan has seen a number of protests against him and his China-friendly policies. The demonstration in Taipei on October 25th was the biggest yet. The opposition Democratic Progressive Party (DPP), which organised it, claims 600,000 took part. One lorry bore an enormous black jackboot decorated with the stars from the Chinese flag, threatening to stamp on the president.

The protest was sparked by the planned visit to Taiwan of Chen Yunlin, Beijing's top negotiator on Taiwan, for talks starting on November 3rd, the first Taiwan-China negotiations ever held on Taiwanese soil. Mr Chen will be the highest-level Chinese official to visit Taiwan since the end of the civil war in 1949.

The protests have been given momentum by disillusionment with Mr Ma and anger at imports of tainted milk and other food from China. At least one-third of Taiwan's 23m people think that the self-ruled democratic island should be independent. But Mr Ma won a resounding election victory in March on a platform of liberalising ties with China. Since then, hopes that the economy would improve under his rule have been dashed; and his approval ratings have recently shrunk to around 24%.

Taiwan's exports are suffering as global demand weakens. And Mr Ma's opening to China has had little impact. An agreement to allow flocks of Chinese tourists to visit the island has seen far fewer visitors than Mr Ma's target of 3,000 a day.

Mr Ma hopes Mr Chen's visit will make a difference. The two sides are due to agree on their first direct air- and sea-cargo links, and a new air route that for the first time does not go via Hong Kong airspace, cutting the journey from Taipei to Shanghai by more than an hour. Economists are enthused about direct links. Their absence has excluded Taiwan from global supply chains. They will also make it easier for the 1m Taiwanese businessmen in China to come home to spend their money.

Both Taiwan and China have played down the political implications of the forthcoming talks. George Tsai, a professor of politics at Taipei's Chinese Culture University, says China sees Taiwan's economic doldrums as a "golden opportunity" to enhance its image and promote irreversible economic integration.

More heated rallies are expected. The DPP's chairwoman, Tsai Ing-wen, says her party will dog Mr Chen wherever he goes. Some 7,000 police will be on alert. There is alarm over Mr Chen's safety after his deputy, Zhang Mingqing, was shoved to the ground in Taiwan in late October. Wang Ting-yu, a local DPP politician, and six associates have been charged. This week Mr Wang claimed that Mr Zhang had merely tripped, and that a gangster had forced him at gunpoint to apologise. Tempers in Taiwan are running high.


WORLD
ASIA

Japanese politics

Keep 'em guessing

Oct 30th 2008 | TOKYO
From The Economist print edition

Aso, having a pretty good crisis, plays for time

Illustration by David Simonds



NOTCH this up for Taro Aso, Japan's third unelected prime minister from the Liberal Democratic Party (LDP) in little more than two years: he is now unlikely to beat Japan's record of 54 days for its shortest-lived leader. Give the wily Mr Aso credit, too, for leading the opposition by the nose since he came to office on September 24th. The Democratic Party of Japan (DPJ) had thought it had Mr Aso's assurance that he would soon dissolve the Diet (parliament) and call a snap election, one which the DPJ's leader, Ichiro Ozawa, claims will shatter the post-war structure of LDP-led politics. An election date of November 30th was probable. To bring on the moment, the DPJ, which controls the Diet's upper house, hastened the passage of LDP bills rather than obstructing them. It fine-tuned its list of candidates, and ran up campaign posters. A palpable excitement ran through the opposition camp.

But then on October 30th, with a poker face, Mr Aso suggested that now was no time for a frivolous election. The global financial crisis called for firm leadership. A wave of selling has sent the stockmarket down to levels not seen in almost 30 years. Hedge funds have unwound with a vengeance a once-profitable "carry trade" for which they had borrowed the Japanese currency: this has sent the yen surging, while households have also rushed to bring yen home. Japan's financial institutions, it turns out, have created their own toxic derivatives, thanks to complex foreign-currency products sold to retail investors that are now blowing up. Meanwhile, banks count shareholdings as a crucial part of their capital. So after the stockmarket falls, the banks' capital suddenly looks weak. The government has drawn up a raft of emergency measures to restore confidence, many of which Mr Aso also unveiled on October 30th (see article). He has a duty, he says, to see them through.

Mr Aso has also discovered international obligations. After attending the Asia-Europe summit in Beijing, he says Japan needs a fully functioning prime minister for the Group of 20 countries' emergency meeting on the financial crisis, to be held in Washington on November 15th. And a week after that there is the summit of the Asia-Pacific Economic Co-operation, APEC, A Perfect Excuse to Chat.

All responsible stuff. But an unspoken reason for delay is a slide in his ratings. Mr Aso has long been a fairly popular politician for getting out and shaking hands. An upbeat style makes a refreshing change from his two predecessors. Most importantly, he has outpolled the bruiser Mr Ozawa, even though voters have consistently said that they prefer the DPJ to the LDP-led coalition. From the start, Mr Aso's strategy was to capitalise on this paradox. His aim was to paint the election, when it came, as a contest between himself and Mr Ozawa, whose robustness has been undermined by poor health. A contest based on personalities would be an exception.

Yet Mr Aso's standing in opinion polls has slid since he took office, narrowing the gap with Mr Ozawa: his honeymoon was brief indeed. The economic storm has given him reason to hang on, but not helped his popularity. Mr Aso is wealthy and likes the high life. For all but five nights of his first month, he and his retinue went out to expensive bars and restaurants. He no doubt deserves his cigar and brandy. But as Japan tightens its belt, his irritable defence of how he likes to unwind has grated.

As for the eventual date for an election, Mr Aso appears content to extemporise. Most LDP leaders agree that the economic turmoil makes early polls inadvisable, and one is not due until next September. However, the government's junior coalition partner, New Komeito, is upset at Mr Aso's change of mind. Next summer it faces municipal elections in Tokyo, its power-base. It worries that it lacks the resources to fight two elections back-to-back, and will continue to push for an early poll.

The opposition, outfoxed by Mr Aso, is temporarily flummoxed. Susumu Yanase, the DPJ's election-affairs chief in the upper house, says the party is rapidly having to rethink its strategy. Having supported Mr Aso's first supplementary budget, it might look irresponsible if it opposed Mr Aso's new emergency measures. As for the other legislation crucial to the LDP—reauthorising the bill that keeps Japanese navy tankers on a refuelling mission in the Indian Ocean, for the war in Afghanistan— Mr Yanase says the DPJ lacks the leverage it had last year, when its blocking tactics succeeded in bringing the vessels home for a period. Now, Mr Aso has enough time to pass the bill by using the government's supermajority in the lower house before the current mission expires in mid-January.

Apart from seeming to enjoy himself as prime minister, Mr Aso may have a final reason for not wishing to call a general election soon: that he might win it. No one expects the LDP coalition to keep its supermajority, but it has a chance of retaining a slim majority. For some LDP modernisers, that would be the worst outcome: an unprincipled ruling party without a scrap of reforming zeal under Mr Aso, combined with a hung Diet promising gridlock.

For as long as November 30th was the mooted date for an election, conspiracies within the LDP mounted. Hidenao Nakagawa, a former chief cabinet secretary and enemy of the bureaucracy, and Yuriko Koike, a former defence minister, wondered about leading followers of Junichiro Koizumi, the reformist prime minister who dominated politics from 2001-06, out of the party. Mr Aso's economy minister, Kaoru Yosano, a fiscal conservative, and Hiroyuki Sonoda, the LDP's deputy policy chief, have been urged to form a new political party following an Aso win, teaming up with pragmatic reformists in the DPJ (who are unhappy with their own leader). Such a move after an LDP victory could instantly bring Mr Aso down, and usher in DPJ-led rule. But now, all hands are at the pump to deal with the financial tempest; conspiracies have been put on hold.

The Maldives

Another country

Oct 30th 2008 | MALE
From The Economist print edition

A long-serving dictator goes quietly

AFP



The wheels came off at last for Gayoom

"IN POLITICS in this country," Mohamed Nasheed once told *The Economist*, "you're either in government or in jail." Under house arrest at the time, Mr Nasheed, known as Anni, had indeed until this year spent elections in the Maldives either locked up or in exile. Yet on October 28th he won 54% of the votes in a run-off election, to oust Asia's longest-serving leader, Maumoon Abdul Gayoom, after 30 years in power. Remarkably, Anni the jailbird is now Anni the president.

So ends a regime that has ruthlessly stifled dissent, yet has, since street protests from 2003, adopted some democratic reforms, including a separation of powers. To his credit, Mr Gayoom this week meekly accepted defeat. As results were announced, pickup trucks and motorcycles circled the island capital, Male, and yellow-clad Anni fans cheered their triumph.

But when the celebrations die down in Male and the 200 inhabited islands across which the Maldives' 370,000 people are scattered, Mr Nasheed's opposition alliance will not find life easy. Bowing to pressure from other opposition groups backing him, he has already promised to hold a fresh election in the middle of his five-year term. If he is to win it, his government will need to revive a flagging economy and keep some of his election promises. That may be hard in a global recession. A further complication is that Mr Gayoom's Dhivehi Rayyithunge Party still commands a majority in parliament, and an election is not due until February.

Famous as a luxury honeymoon resort, and as the country perhaps most at risk from rising sea-levels, the Maldives has long had a secret other life: as a dictatorship. Tourists, whisked in speedboats from the airport to remote islands, were sheltered from its ugly politics. Critics accuse Mr Gayoom of nepotism and of siphoning off profits from tourism. The country has fallen 31 places in a year in an index of perceived corruption compiled by Transparency International, an NGO. Mr Gayoom recently had to defend himself against allegations that he embezzled $40m provided as relief after the tsunami in 2004.

Expectations of change are high. Mr Nasheed's Maldivian Democratic Party (MDP) campaigned under the slogan "*Aneh Dhivehi Raajje*" ("The Other Maldives"). But the country faces social problems not susceptible to a quick fix: overcrowding; high youth unemployment; rising crime; and a heroin epidemic, with up to 30,000 drug users, according to unofficial estimates. And in a hitherto moderate Islamic nation, religious extremism poses a new threat. In September 2007, 12 tourists were injured in a terrorist bombing in Male. The religiously conservative Adhaalath Party, which advocates the death penalty for apostasy, has backed Mr Nasheed in return for a stake in the government. Its views will be hard to reconcile with those of a liberal younger generation attracted to the MDP.

Mr Nasheed made economic development the main plank of his election campaign. He promised to balance the budget and diversify the economy, at a time when the growth in tourism seems to be slowing. The Maldives is still the richest country in South Asia in terms of GDP per head. But growth has levelled off. The fiscal deficit stands at 30% of GDP, and foreign reserves have slumped to $116m.

The danger facing Mr Nasheed is that the global economic turmoil dents tourism and condemns the Maldives to hard economic times and divisive politics. The hope, however, is that his astonishing election victory heralds the emergence of the archipelago as a genuine Islamic democracy: a beacon in the region and beyond.

Pakistan's economy

Treacherous ground

Oct 30th 2008 | DELHI
From The Economist print edition

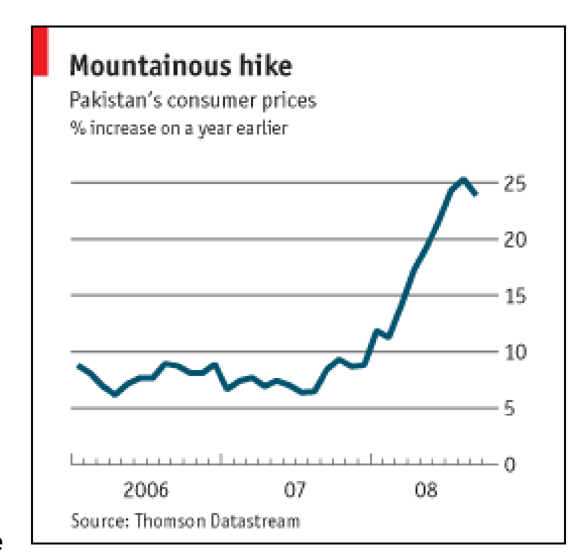
An earthquake adds to Pakistan's woes



ON TOP of a bloody insurgency and a listing economy, Pakistan must now contend with a natural calamity. Before dawn on October 29th, an earthquake of magnitude 6.4 or greater struck the mountainous province of Baluchistan not far from its capital, Quetta. The death toll quickly exceeded 200.

It was the biggest earthquake since one in October 2005 that killed over 70,000 in Pakistan-controlled Kashmir. After that catastrophe, America spent almost $1 billion on relief operations, ferrying supplies to mountain villages by Chinook helicopter. According to one American official, cited by an independent working group on Pakistan policy, the goodwill America earned represents "the most successful strategic confrontation to date in the battle with the terrorists in South Asia."

Even before the latest earthquake, Pakistan was again hoping its strategic position would persuade the world to rush to its aid. The ground is giving way beneath its economy. A distracted, overstretched government has allowed inflation to soar (see chart), the rupee to plummet and foreign-exchange reserves to seep away. On October 17th the central bank's stash of hard currency was just over $4 billion, enough to cover just four to five weeks of imports.



Pakistan hoped for an infusion of cash from the "Friends of Pakistan", an informal circle including China, America and Saudi Arabia. But to its dismay, only the IMF appears ready to offer the sums it needs as quickly as it needs them. The IMF is expected soon to approve a loan of up to $12 billion, probably spread over two years.

Pakistan and the IMF may not be "friends"; but nor are they strangers. Some of the politicians and civil servants now in power were "pretty traumatised" by the IMF programmes they endured during the 1990s, says Mohsin Khan of the fund. In those days, the IMF twisted their arms to make tough fiscal commitments they could not keep. In 2005 the military regime, having proudly turned down the last two instalments of its loan, declared that it had "broken the begging bowl forever".

Which arms will be twisted this time? Pakistan's newspapers are

full of speculation. One even suggested the IMF would slash the army's budget by 30%. But that is far beyond the fund's mandate. "We are economists not defence specialists," says Mr Khan. The government perhaps has less to fear than it thinks. It has already decided to grasp the most painful macroeconomic nettles on its own. In a plan drafted in September, it resolved to cut the budget deficit to 4.3% of GDP, refrain from borrowing from the central bank and remove fuel and electricity subsidies. If it can do all that, the fund will have little more to add except money. No arms need be twisted.

But the government is struggling to keep its own promises. Bravely, it has raised fuel prices, even as the cost of crude has dropped. The price Pakistanis now pay at the petrol pump is more or less the market rate, Mr Khan says. But the government still had to borrow from the central bank last quarter. More seriously, it this week reversed its decision to raise electricity prices by 31%. Households and firms are loth to pay more for power that now seems to run only every other hour. Some of them burned their bills in the streets instead.

It seems clear, then, that Pakistan will soon enter an IMF rehabilitation programme. But it's not at all clear it will finish it. What is economically necessary may not yet be politically feasible. If so, later instalments of the IMF loan will be withheld. The danger is that Pakistan may have to endure the greater evil of fuel shortages, currency controls and even default before it accepts the lesser evil of stiffer taxes, higher electricity bills and the IMF.

Central Asia and the financial crisis

After the boom

Oct 30th 2008 | ALMATY
From The Economist print edition

Wondering if the good times are over



FOR almost a decade, oil-rich Kazakhstan has been the economic engine of Central Asia. Since 2000 its GDP has grown by an annual average of around 10%. But now the global financial crisis is taking its toll and the Kazakhstani motor is spluttering. In 2008 the economy is expected to grow by just 5%, which sounds healthy but is still a wrenching slowdown.

Kazakhstani officials were long in denial about the crisis. But in mid-October President Nursultan Nazarbayev announced a series of measures to deal with it. Since then, the government, criticised for inaction, has gone into overdrive. Mr Nazarbayev has given Karim Massimov, the prime minister, a free hand to take any steps necessary to stabilise the economy. Mr Massimov has taken on the job with relish, declaring almost daily that everything is under control.

Indeed, some Western forecasts that Kazakhstan is following Iceland and the Ukraine towards national insolvency, seem far-fetched, or at least premature. Kazakhstan has $48.4 billion in foreign reserves, including $27.4 billion in the national oil fund, to help it weather the coming financial storms. By year-end, the government will inject a total of $15 billion, equivalent to some 15% of GDP, into the economy. This includes a $5 billion bail-out for local banks, under pressure because of their heavy foreign borrowing.

Yet things are bleaker than the government wants to admit. Sharp declines in commodity prices and demand for metals have led Kazakhstan's big mining companies to cut production and send thousands of workers on leave at half-pay. The drop in oil prices means it will not be possible to replenish the national oil fund as quickly as might be needed. “The safety cushion that we had has disappeared,” says Tulegen Askarov, a well-known economist. Moreover, no detailed programme has been revealed on exactly how the $15 billion will be used—alarming in a country notorious for corruption. “This lack of transparency scares everyone and undermines the trust,” says Mr Askarov.

Kazakhstan's economic troubles are also casting a shadow on its neighbour Kyrgyzstan, where several Kazakh banks have operations. Kyrgyzstan is a much smaller and poorer country, with only $1 billion in gold and foreign-currency reserves. Turkmenistan and Uzbekistan, in turn, are economically too isolated for the crisis to have had much impact yet.

It may be months before the full effect of the economic slowdown hits the region. Hundreds of thousands of migrants from Kyrgyzstan, Tajikistan, and Uzbekistan work in Kazakhstan and in Russia, especially in construction. As they are laid off and forced home, it may cause social tension. And remittances, a big source of foreign-exchange revenue in the region, could fall steeply in a prolonged slowdown.

Grigory Marchenko, boss of Halyk Bank, Kazakhstan's third-largest, remains sanguine. He recalls the 1998 financial crisis, when Russia defaulted, oil fell to $10 a barrel, and Kazakhstan had its worst harvest in decades. Yet its economy started to grow the very next year, and to boom in 2000. For history to repeat itself in Kazakhstan, however, the shock to the global economy from the 2008 crisis would have to be less severe than many expect.

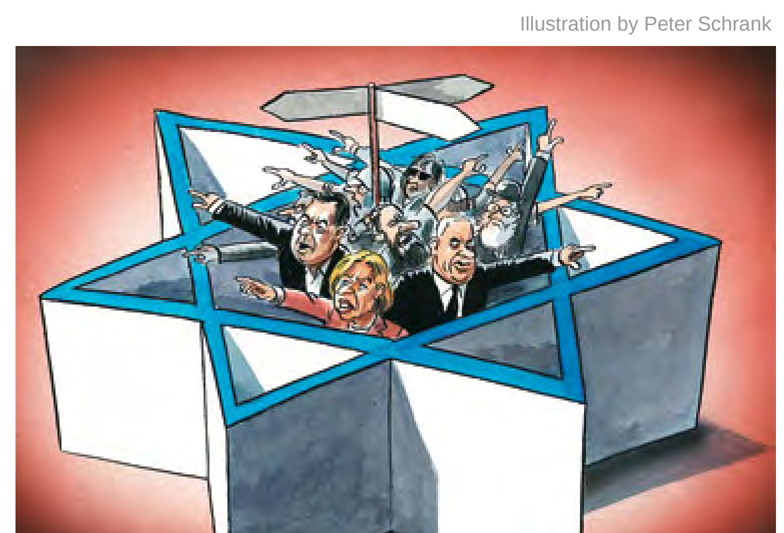
Israel

Into the electoral maze

Oct 30th 2008 | JERUSALEM
From The Economist print edition

A power vacuum until the vote in February, and no clear victor in sight

Illustration by Peter Schrank



AFTER more than a month of negotiation, Israel's foreign minister, Tzipi Livni, who was recently elected head of Kadima, the biggest party in the ruling coalition, has given up her struggle to form a fresh coalition government. Instead, a general election will be held in February. The latest opinion polls put Ms Livni a shade ahead of Binyamin Netanyahu, leader of the right-wing Likud party, with Ehud Barak of Labour far behind in third place.

Until a new government is sworn in, usually after a further month or two of post-election haggling, Ehud Olmert will remain in office as prime minister. Israel's parliament, the Knesset, will dissolve itself on November 11th but can reconvene if urgent legislation is needed. So for the next four or five months, Israel will be without a government likely to take big new initiatives or make tough decisions, especially on the international front.

Mr Olmert announced in July that he was stepping down over allegations of corruption, which he denies. Now he is a mere caretaker. Even if peace talks with the Palestinians and Syrians continue under his direction, they are unlikely to produce agreements. Renewed interest in a peace plan drawn up by the Saudis in 2002 will be subsumed into the election debate, with Kadima and parties to its left embracing at least large parts of the plan, whereas the Likud and its allies disparage it.

Ms Livni's efforts to create a new coalition in the current Knesset ran aground over demands by Shas, a Sephardic-Orthodox party, that she increase child allowances by 1.5 billion shekels ($400m) and undertake publicly not to negotiate with the Palestinians over the status of Jerusalem. Ms Livni offered Shas less money and only vague words about the Holy City.

In any event, Shas may have made a strategic decision to ally itself with the Likud. Such decisions in Israeli politics can be short-lived. But the Sephardic-Orthodox party's tactics do seem to portend a re-emergence of the right-religious axis that underpinned Likud-led governments for much of the past three decades, since Menachem Begin first led the Likud to victory in 1977. An Ashkenazic-Orthodox grouping, United Torah Judaism, took Shas's lead and also fended off Ms Livni's overtures.

The Likud and Labour will say that Ms Livni lacks the experience to run the country, though she has been nine years in the Knesset and seven in the cabinet. True, Mr Netanyahu and Mr Barak have each been prime minister. "Inexperienced" is sometimes an Israeli euphemism for not having been a general. Mr

Barak was the country's most decorated soldier and rose to become army chief of staff. Mr Netanyahu was only a captain but in the army's most elite commando unit, which his brother, Yoni, commanded heroically.

Kadima will dwell on the three leaders' personalities. Ms Livni projects a cheerful, businesslike manner, though a trail of discarded aides say she is hard to work for. Mr Barak and Mr Netanyahu, both loners, both autocrats, have long histories of feuding and betrayals in their own parties. Both claim to be changed characters since they were last in power. Mr Netanyahu, at least, now turns up to meetings on time, pays for his guest's cup of coffee and above all appears to listen more. Mr Barak still has difficulty in appearing to listen to voices other than his own.

The mood in once-dominant Labour is glum. Pollsters say that barely 10% of voters now back it. One senior figure, Binyamin Ben-Eliezer, made matters worse this week by suggesting that Labour should amalgamate with Kadima. Both parties, after all, support a two-state solution with the Palestinians, based on extensive Israeli withdrawal and land-swaps. Mr Netanyahu favours what he calls "economic peace", says Jerusalem is non-negotiable and insists on "security control" of large parts of the West Bank.

Mr Ben-Eliezer's merger idea was shot down by the party faithful, but showed up the problem Labour will have in carving out its own agenda. Mr Barak made a first, awkward attempt, saying that Labour would assail the "pig capitalism" of the right. The Likud said Mr Barak was preaching to voters "from the giddy heights of Akirov Towers", a posh Tel Aviv apartment block where he has an expensive flat.

If the Orthodox parties do line up with the Likud, the shape of the new government may hinge on a Russian immigrant party, Yisrael Beiteinu, led by Avigdor Lieberman. Many former Soviet immigrants like Mr Netanyahu's hard line on the Palestinians. Ms Livni, shorn of Shas, will offer a government without Orthodox parties and without their religious agenda. Many ex-Soviet voters, who tend to be secular-minded, will find that attractive, too. In any event, nobody is predicting with any certainty who will win.

Syria

A puzzling raid

Oct 30th 2008 | DAMASCUS
From The Economist print edition

An American attack on Syrian soil has rattled Syria and raised many questions

AFP


But why did they die?

MYSTERY surrounds an American commando raid on a farm on the Syrian side of the border with Iraq on October 26th. The Syrian government said that eight civilians had been killed, including a woman and three children. The Americans suggested that the target of the incursion was a leading al-Qaeda man but were reluctant to confirm whether he was dead or alive. Some reports said that at least one body had been airlifted out. The mood in Damascus, Syria's capital, was one of perplexity, twitchiness and anger.

Early this year an American Treasury report accused Syria of harbouring an Iraqi-born resident called Abu Ghadiyah and his family, who apparently ran a network for foreign jihadists, providing them with false passports, weapons, guides, safe houses and allowances for those bound on missions into Iraq. Ever since the invasion of Iraq in 2003, the Americans have accused Syria of letting infiltration chains ("rat lines") of fighters operate with impunity. But more recently the Pentagon has acknowledged that the number of would-be jihadists crossing into Iraq from Syria has been dipping.

The timing of the raid, a week before America's presidential election, was striking. A parting gift from George Bush in an effort to boost John McCain? Or a poisoned chalice for Barack Obama? "I think this is the end of the Bush administration," a spokeswoman for Syria's government told al-Jazeera television. "I think it's personal revenge." Syria's foreign minister, Walid al-Mouallem, called it "cowboy politics" and "a war crime" and said he was "astonished" by the action. As a gesture of annoyance, the government closed the American School in Damascus, to which many well-heeled Syrians as well as foreign residents send their children.

Samir al-Taqi of the Orient Centre for International Studies, a Damascus think-tank close to government, said the raid would be a crisis for the next American president to inherit. But the Syrian government's recent overtures towards Israel, in the shape of indirect talks under Turkish mediation, would not, he reckoned, be affected. "Already the Israelis have set themselves aside from this event. I think they are wiser than the neocons in Washington." Syria's efforts to improve relations with European Union countries, led by France, would also continue apace. A day after the raid, Mr Mouallem held friendly talks with his counterpart in London.

What makes the raid odder still is that the Syrian authorities have themselves embarked on a nationwide confrontation with al-Qaeda types in Syria, following a string of puzzling incidents. In February Imad Mughniyeh, the guerrilla mastermind of Hizbullah, a Lebanese Shia party-cum-militia that is aided by Syria and Iran, was blown up in Damascus (by Israel, says Hizbullah). In August, a leading Syrian general, Muhammad Suleiman, was murdered in strange circumstances. In September, a car bomb on the edge of Damascus killed 17 people. Recently there have been reports of shooting in Yarmouk Palestinian camp, the largest in Syria, also on the outskirts of Damascus. Some Syria-watchers have surmised that the American attack was carried out with the complicity of the Syrian authorities, even though it was incumbent on them to complain after the event.

The authorities have been arresting dozens of suspected Sunni Islamist extremists. It has also been reported that they may expel 80-odd scholars of the puritanical Saudi Wahhabist school, especially those trained in Saudi Arabia or Pakistan. Though the state-run media have been coy, residents of Yarmouk have reported arrests and gun battles in their area, including a recent incident when at least two women were arrested in possession of explosive suicide-belts.

The authorities seem rattled. “I think the situation has changed,” says a Western diplomat. “The basic message from the leadership is that now Syria has become a victim of international terrorism and that’s how they see themselves.” Syria has been edging back into the regional diplomacy. The next few months, no matter who is elected America’s president, could be busy—and nerve-racking.

Africa's economy

Trying to weather the storm

Oct 30th 2008 | JOHANNESBURG
From The Economist print edition

The global crisis hits Africa’s economy but not as badly, yet, as elsewhere

AT FIRST relatively shielded from the turmoil in global markets, sub-Saharan Africa is starting to feel some pain. Worst affected is South Africa, the region’s largest economy, because it is most tightly linked to the outside world. The rand has been in free fall, losing about 30% of its value against the dollar since the beginning of September; the local stockmarket is also grim, with falls in line with those in New York and London. Yet South Africa’s economy, together with the rest of the region’s, may yet prove more resilient than most, once the dust settles.

The rand has often been volatile: it took severe knocks in the mid- and late 1990s, then again in 2001. The latest dive has several causes. It has followed the currencies in Europe, its main trading partner, against the dollar. In addition, the rand’s performance remains closely tied to commodities such as platinum and coal, whose prices have fallen on the back of global recession fears. Even gold, usually a refuge, has not been doing that well. Cash-strapped foreign investors have been selling their South African portfolio assets, hurting both the currency and the stockmarket. So far this year, foreigners have sold a net 48 billion rand ($6.1 billion) of local stocks, compared with a net buy of 62 billion rand this time a year ago.

Yet South Africa still looks in fair shape. Capital controls, financial-sector regulation and good banking supervision have shielded local banks from the risk of bankruptcy and cash crunch that have gripped Europe, America and Asia. Though ordinary South Africans are feeling the pinch of higher interest rates, with repossession of cars and houses on the rise, local banks seem healthy enough still to be lending.

Commodities make up a good chunk of exports, but mining accounts for only 5% of the country’s diverse economy. Consumer borrowing and spending have slowed due to high interest rates, but public investment in infrastructure should sustain some economic growth. Iraj Abedian, a local economist, reckons that the economy will expand by about 3% this year, and between 2.7% and 3.3% next year. This is slower than in the past few years, but not dismally so. As growth slows and oil prices slump, annual inflation, which reached 13.6% in August, is expected to ease back to its 3-6% target towards the end of next year.

Unfortunately, the current account deficit has ballooned to an expected 7.6% of GDP this year; South Africa has relied on foreign money to finance the gap. Even when the global cash squeeze eases, there will be less liquidity than in the past few years. Interest rates will probably need to stay high to keep foreign money coming.

Foreign money will need reassurance anyway. Jacob Zuma, South Africa’s likely next president, and other leaders of his ruling African National Congress (ANC) have been telling investors that economic policy would not change drastically. But many businessmen worry that the next government may pander a bit more to its trade unions and communist allies.

There has been little sign of a shift. In his mid-term budget speech on October 21st, Trevor Manuel, the finance minister, said that the budget, still expected to be in surplus this year, would run a modest deficit of 1.6% of GDP next year, due to the slowdown and some extra spending to soften the blow. The central bank’s governor has also said that inflation targeting should be maintained. So no signs of recklessness. But investors will watch closely to see what happens after the election next year. In any case, current economic conditions will reduce the elbow room for any government keen to veer left.

More pain further north

So far, most of the rest of sub-Saharan Africa seems to have avoided contagion, but the real economy is

likely to suffer. Most African stockmarkets are tiny and illiquid, except for Johannesburg's much bigger exchange, and to some extent Nairobi and Lagos, where foreign involvement is relatively small. Local banks have fewer links with the rest of the world, consumer credit is sparse and derivatives rare.

Still, Nigeria's and Kenya's stockmarkets have been hit. But, though foreign portfolio investors taking their money out did not help, this year's poor performance of the stockmarket in Lagos, Nigeria's commercial capital, was caused mainly by local factors and predates the global crisis. In March the authorities pressed local banks to limit lending to local retail investors keen to join the stockmarket frenzy, which started to fizzle as a result.

But plunging commodity prices and reduced foreign demand will hurt quite a few African economies; foreign investment, remittances and foreign aid will all shrink. The diving oil price will hit producers such as Nigeria, though the region's many oil importers are sighing with relief. Nigeria's naira has held up well but other currencies have been weaker. As copper prices have tumbled, Zambia's has fallen by 24% against the dollar since August. Other domestic factors, such as Kenya's political fragility following post-election violence earlier this year, have also hurt local currencies, with latest inflation up to 15% and food prices rising even faster.

Sub-Saharan Africa depends less on commodities than it used to. Its economies have grown faster on the back of rising private consumption by a burgeoning middle class. Slower world growth may dim its prospects and test its improved fiscal discipline. But the IMF forecasts that sub-Saharan Africa will still expand by 5.9% this year and 6.2% next, after 6.7% in 2007—far perkier than the 3% expected worldwide.



Slavery in west Africa

A continuing abomination

Oct 30th 2008
From The Economist print edition

A landmark ruling provides hope for thousands of slaves in the region

AFP



Free at last

BORN into slavery in Niger, Hadijatou Mani was just 12 years old when she was sold for the equivalent of $400 to a wealthy Muslim businessman with four wives. At 13, she was raped for the first time by her new master, going on to bear him three children, two of whom survived. Both were taken from her. For almost nine years, she had to work long hours in the fields and in his home without pay. If she did anything wrong or tried to escape, she was beaten. But after she fled and married a man of her own choice, she was charged with bigamy and sentenced to six months in jail. “No woman”, she says, “should suffer the way I did.”

Enslaved women may not have to for much longer if a recent landmark ruling by a west African court, finding Niger in breach of both its own and international law for failing to protect its citizens from slavery, is properly enforced throughout the region—which is not very likely. It nevertheless provides a first ray of hope not only for the estimated 43,000 inherited slaves in Niger, but also for tens of thousands of others in west Africa, notably in Burkina Faso, Mali and Mauritania.

It is the first time that the Community Court of Justice of the Economic Community of West African States (ECOWAS), whose rulings are binding, has heard a case of slavery. The practice’s prohibition is a fundamental principle of international law, binding on all states whether or not they have ratified the key treaties such as the 1926 UN Slavery Convention or Africa’s own 1981 Charter on Human and Peoples’ Rights, which also bans it. There can be no exceptions and no excuses for non-compliance.

Like most newly independent African states, Niger incorporated the ban into its own constitution. But it continued to turn a blind eye to the practice even after making it a crime in 2003, with a penalty of up to 30 years in jail. Threatened with prosecution, Ms Mani’s master, Souleymane Naroua, agreed to free her, only to reclaim her on her release as his wife under Niger’s customary laws.

Backed by lobbies such as London-based Anti-Slavery International, Ms Mani took her case to a local tribunal, which ruled that that she was not legally married to her old master. But the ruling was overturned after she married a man of her own choice. She was convicted of bigamy and sentenced, along with her new husband, to six months in prison and a fine of 50,000 CFA francs ($120), a hefty sum in a country where the average income is around $2 a day.

But now the ECOWAS court has overturned that ruling—and awarded her the equivalent of $19,000 in damages.

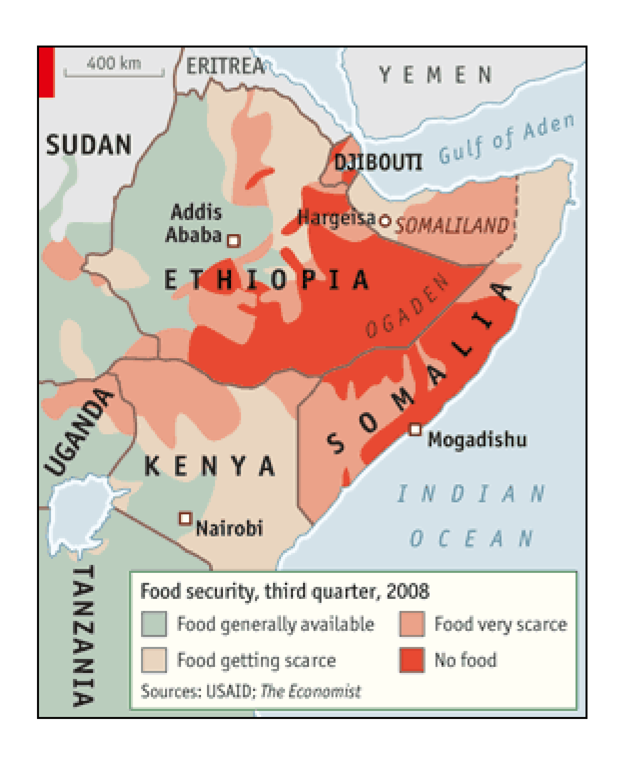


The Horn of Africa

The tragedy of the decade?

Oct 30th 2008 | NAIROBI
From The Economist print edition

Millions of people in dire need of help



ONE result of Ethiopia's dreadful famine in 1984, when at least 1m people starved to death, was the invention of celebrity activism on behalf of the world's most miserable. Band Aid, then Live Aid, then ever more sophisticated networking and the airing of films of starving children on television helped persuade rich countries' governments to double aid to Africa as part of a wider set of promises to meet the UN's eight Millennium Development Goals laid out in 2000, the first of which is to "eradicate extreme poverty and hunger" by 2015. Despite progress in setting up early-warning systems, better procurement methods and the rapid delivery of nutrition in the form of foil packets of plumpy nut, the Horn of Africa has remained a hunger zone.

The UN's World Food Programme (WFP) says the present drought is the worst there since 1984. The International Committee of the Red Cross, which is usually slow to press the panic button, says it may be the tragedy of the decade. At least 17.5m people, the agencies reckon, may face starvation. The WFP is trying to feed 14m of them. High food prices, together with civil strife, the assassination of aid workers by jihadists, and piracy against food convoys sailing from Kenya to Somalia have combined with drought and desert to create a catastrophe. Some 12m of the hungry are in Ethiopia, 3m in Somalia, 2m in Kenya and Uganda, the rest in Eritrea and Djibouti.

Aid workers are getting better at stopping mass starvation. Fewer people will die than in 1984 or 1992, when Somalia was famine-stricken. But doctors at feeding clinics in affected areas say that children are already dying of illnesses linked to malnutrition, such as diarrhoea, heart failure, pneumonia and other infections. Survivors may be physically and mentally stunted, and ravaged by sores. Fighting in Ethiopia's Ogaden region and across Somalia makes it more expensive to reach the hungry. The WFP says it needs an extra $572m to keep people alive until April. Falling oil prices may reduce transport costs, but not by much. A shortage in the region's markets has forced the WFP to buy most of its food from distant South Africa.

An extra worry is that the world's financial turmoil may reduce remittances from the Horn's vast number of émigrés, putting more people at risk of starvation. The African Union, based in Addis Ababa, says a

famine would wreck the region’s prospects and worsen general instability. Fighting between desperate pastoralist groups has already increased.

Côte d'Ivoire

Election jitters

Oct 30th 2008 | ABIDJAN
From The Economist print edition

Would-be presidents have begun to campaign but the country is not ready

THE mood is febrile. Campaigning for a long-awaited presidential election has begun. Two leading contenders—the incumbent, Laurent Gbagbo, and Alassane Ouattara, a former IMF man—have held lavish, high-tech conventions where dancers, praise-singers and scantily-clad hostesses have been consorting with the politicians and their American-style PowerPoint presentations. Henri Konan Bédié, a former president, has presented himself as the third serious candidate. But there is a snag. The politicians are rearing to go but the election organisers are not. The official deadline for the vote, November 30th, looks sure to slip. And few Ivorians think an election will solve the country's political impasse anyway.

The main obstacle is identifying who is qualified to vote. In theory, the 9m-odd voters should have been registered by the end of August to give all sides time to check the lists. This is particularly important in Côte d'Ivoire because arguments over nationality have been at the heart of a crisis which, since a civil war in 2002-03, has divided what was once west Africa's most stable and prosperous country. In reality, registration—of a symbolic kind—started only in mid-September. Mr Gbagbo said all voters could be registered in 45 days. So far just a fraction have been. The thousands needed to handle registration are still being recruited and trained. The president now hints at a delay.

Then there is the expense. The election may cost some 36 billion CFA francs ($70m); providing all adult Ivorian inhabitants with identity cards may cost even more. Mr Gbagbo and Guillaume Soro, a leader of the New Forces rebel movement that seized the north during the civil war who became prime minister under last year's peace deal, say that finance for the polls has been secured. But election workers complain that the cash has yet to trickle down—and its absence is causing delays.

Another obstacle is the failure of armed men on both sides to disarm. If and when the polls take place, the rival armies are supposed to remain in place—but they will be armed. Rebels who have disarmed have the keys to the houses where their guns are kept. Unified brigades, combining soldiers from both sides, are supposed to have replaced UN and French peacekeepers in a buffer zone between the rebel north and government south. These brigades are supposed to number tens of thousands and should provide security at election time. In fact, they hardly exist. The two sides are still quarrelling over the number and rank of rebels in the new army. Rebel and government forces have both staged protests over pay, setting up barricades and shooting into the air.

In any event, the candidates are not a reassuring lot. Mr Gbagbo was a fiery opposition leader who fought for years against Félix Houphouët-Boigny, who ruled Côte d'Ivoire for decades. Mr Gbagbo's clan indulges in rampant corruption, especially in cocoa, which accounts for a third of exports and is worth $1.5 billion a year. With oil soon to be extracted in large amounts, Mr Gbagbo's people will be keener still to hang on to power. Mr Bédié became president after Houphouët-Boigny died in 1993, made a hash of things, and offers little new. Mr Ouattara, long kept out of politics because his foes said he was not a native Ivorian and so was disqualified, proved his economic credentials at the IMF and in regional economic bodies but might find it hard to hold the fragile country together.

Who can help keep the electoral show on the road—and arbitrate after the count? The deal in 2007 was finally brokered by Burkina Faso's president, Blaise Campaoré. He may still be best suited to knock heads together. France, which pulled the strings behind the scenes for decades after independence in 1960, seems to have lost heart since anti-French riots in 2004 sent thousands of French expatriates rushing home. It has deployed 1,800 peacekeepers under the UN's aegis, trying to keep northerners and southerners apart, but the French government seems keen, as soon as the election is over, to send them home. Would Côte d'Ivoire then stand peacefully on its own feet? No one is sure.

Correction: Africa's prospects

Oct 30th 2008
From The Economist print edition

In our briefing on Africa's prospects (Opportunity knocks, October 9th) we said that foreign ownership of banks in South Africa and Nigeria was limited to 5%. In fact, the figure is higher. In South Africa Barclays is a majority owner of ABSA and a Chinese bank recently bought 20% of Standard Bank; in Nigeria the figure is closer to 10%. Sorry.

Germany's foreign policy

The Berlin stonewall

Oct 30th 2008 | BERLIN
From The Economist print edition

Has Germany replaced France as America's awkward ally?

Illustration by Claudio Munoz



SOON after Angela Merkel became Germany's chancellor in 2005, she met George Bush in Washington to open a "new chapter" in relations. Her predecessor, Gerhard Schröder, had been so stridently against the Iraq war that he began to look anti-American. Ms Merkel, by contrast, had backed the war. Germany may belong to "old Europe", as America once dismissed opponents of the war, but Ms Merkel, a child of communist East Germany, had the instincts of a new European. The easing of tensions was helped, too, by President Bush's efforts to repair transatlantic relations in his second term.

Yet frustration is creeping back in. On Russia, Iran and Afghanistan—trouble-spots that matter to both countries—Germany's position is annoying Washington. At the NATO summit in Bucharest last April, Ms Merkel stood most visibly against American pressure to grant a Membership Action Plan—a road-map to join the alliance—to Ukraine and Georgia. This was a marked change from previous summits at which France habitually obstructed American proposals.

After Russian troops pushed into Georgia in August, America wanted to ostracise the Kremlin while Germany appeared eager to return to business as usual. Germany has been the leading Western sceptic in toughening economic sanctions on Iran to discourage its alarming uranium-enrichment programme. In Afghanistan, moreover, Germany's military commitment is hedged with "caveats" that keep its troops out of the fighting in the dangerous south of the country.

In a memorandum to the new American president, the American Institute for Contemporary German Studies, a think-tank, gives warning that Germany and America may "clash" over Iran and that differences over Russia could harm the relationship "severely". In part, Germany's problem is that it can no longer hide behind France now that President Nicolas Sarkozy has moved closer to America. He plans to lead France back into NATO's integrated military structure next year.

"Berlin is the new Paris," says a senior American official; that is where the "tough conversations" now take place. The tone of opinion columns can be merciless. "Germany by itself has enough economic leverage with Iran" to stop it from enriching uranium, thundered a recent article in the *Wall Street Journal Europe*; but for mercenary reasons it is not using it.

Germany's inhibitions are the product of history, trade and tensions within the grand coalition government, which awkwardly yokes Ms Merkel's conservative Christian Democratic Union to the Social Democratic Party (SPD). It does not help that Frank-Walter Steinmeier, an SPD leader and her main

political rival, is also the foreign minister. Still, both think Germany has a special role in oiling the wheels of international diplomacy, serving the interests of its allies even if they do not always appreciate it.

The second world war left Germany allergic to militarism and eager for friendships. First it bound itself firmly into the Western alliance. Then, with Ostpolitik, it also befriended the Soviet block. Its pacific style no doubt helped trade (Germany is the world's top exporter of goods), which in turn makes it more pacific.

Germany is the biggest Western exporter to Iran. Last year Russia was the second-fastest growing export market among Germany's main trading partners. Germany imports more than a third of its oil and gas from Russia. With the collapse of the Soviet Union, Russia's policies diverged from those of its neighbours, which made it harder for Germany to please them all. Mr Schröder's government approved the Nord Stream gas pipeline from Russia under the Baltic Sea, bypassing, and enraging, Poland and the Baltic states. Mr Schröder now chairs the shareholders' committee of the consortium building it.

That said, Germany is reluctantly shedding its merchant pacifism. If Iran continues enriching uranium, Germany is edging towards approving sanctions that go beyond targeting goods related to nuclear proliferation. “Germany is playing a responsible role on Iran,” says a senior Israeli official, whose country has more to fear from an Iranian bomb than any other; Germany's differences with its allies have been “tactical, not strategic”.

On the use of force abroad, Germany has been changing “almost with the speed of light”, says John Kornblum, a former American ambassador to Germany. Before 1992, German soldiers were deployed abroad on strictly humanitarian missions. Now it has the third-largest contingent of troops in Afghanistan (rising from 3,500 to 4,500), including a “quick reaction force” ready for combat, mainly in the north. It has military missions in Lebanon, Bosnia and Sudan. The trouble is, says Mr Kornblum, that “the world is changing faster.”

German officials insist that its comparative advantage will remain its knack for talking to almost everyone. Mr Steinmeier, who will challenge Ms Merkel for the chancellorship next year, is renowned, and often reviled, for not allowing a foreign government's shortcomings to spoil a fruitful relationship. A senior diplomat argues, for instance, that “rhetoric which excludes Russia pushes it in the wrong direction”. He rejects the idea that Mr Steinmeier favours “equidistance” between Russia and the United States, a notion advocated by some members of his party. Ms Merkel, though readier to be blunt with autocrats, nurtures Germany's honest-broker role. Other leaders trust Germany, says her spokesman, because “it has no big-power ambitions”.

Germany hopes that the next American administration will prove easier to deal with than Mr Bush's. But neither Barack Obama nor John McCain will be shy about making demands of American allies, especially when it comes to Iran and Afghanistan. With Germany about to enter its own election campaign, it may take a while to say yes to America.

Espionage

Snoop and scoop

Oct 30th 2008 | PARIS
From The Economist print edition

A spymaster's leaked notes reveal the depth of surveillance in France

FOR nearly 12 years as France's domestic spy chief, Yves Bertrand filled spiral-bound notebooks with every rumour that came his way about the goings-on of the political elite. They were supposed to be a private *aide-mémoire*, he says. But this month they became public when extracts were published by *Le Point* magazine, prompting an outburst of denials, red faces and legal action which has gripped the Paris establishment.

The disclosures so far are relatively coy, yet reveal the deeply pervasive culture of snooping in the country founded on the principle of *liberté*. Where British tabloids would have splashed intimate details across the front page, the French weekly merely hints at "the bisexuality of a certain minister" or the "tab kept by a former prime minister at a top Paris hotel". It names only a few figures. In 2000, for instance, it says that Mr Bertrand had pages of notes on the Trotskyite past of Lionel Jospin, then a Socialist prime minister whose history had yet to be exposed. In October 2003, according to *Le Point*, the spy chief noted that the then president, Jacques Chirac, "had a facelift in Canada." He also wrote copious notes about the marital life of Nicolas Sarkozy, then a government minister and now president, including details of a telephone conversation between his first wife and a friend of hers on the subject of his second wife.

Mr Bertrand left his job as head of the Renseignements Généraux (RG), one of France's domestic intelligence services, in 2004. But as part of an inquiry into the "Clearstream affair", an alleged smear campaign involving the presidency under Mr Chirac, investigating magistrates last January seized 23 of the notebooks, covering the period 1998-2003.

Their publication in *Le Point* has stirred an uproar. Mr Sarkozy, who suspected a plot at the time to destabilise him, has sued Mr Bertrand for false accusation, forgery and invasion of privacy. Arnaud Montebourg, a Socialist deputy, described the notes as evidence of "a little Stasi *à la française*". Mr Jospin, who said that Mr Chirac had protected Mr Bertrand over the years, called for an official inquiry.

For his part, Mr Bertrand insists that he was just doing his job. Nine times out of ten the rumours he picked up, when checked, turned out to be unsubstantiated gossip; he did not use the information to undermine anybody. He says his notebooks included mundane reminders such as "must buy some steak". Being well informed early about any affairs, he ventured, "meant that I was good."

The French seem extraordinarily tolerant about being spied on in their daily life. The tradition reaches back far, and not only to dark times under Nazi occupation. Recently published archive documents from the Paris police headquarters include a leather-bound volume of intelligence files on 415 prostitutes, and two registers containing files on 1,200 homosexuals—all collected by police spies under Napoleon III.

In terms of counter-terrorism, France's robust surveillance apparatus is widely respected. Years of snooping on mosques and in the heavily Muslim *banlieues* has helped to identify jihadists and thwart acts of terrorism. Today, France is merging the RG and another service, the Direction de la Surveillance du Territoire, into a new super-spy agency known as the Direction Centrale du Renseignement Intérieur. It has a combined staff of about 6,000 agents, next to 3,500 at Britain's MI5, for instance. The French seem to accept tight surveillance as the price of security.

French intelligence agents are authorised to snoop not only on those who pose a potential threat to security or public order. Under a 1991 decree they can also monitor more generally those who "play a significant political, economic, social or religious role", such that information about them could help the government to "appreciate the political, economic or social situation and anticipate its evolution".

According to the National Commission for Data Protection and Liberties, an official body, the RG alone holds files on a staggering 2.5m people; the real number, says one insider, is even higher. Those who have secured permission to look at their files are sometimes disappointed by the errors. "The problem

with these files is not their existence but their quality," argues Alain Bauer, a security specialist.

Even the French, however, have their limits. A recent attempt by President Sarkozy's government to computerise all intelligence files into a new super-database, known by the acronym EDVIGE, is being rethought after an outcry by civil-liberties groups. It would have allowed agents to track individuals' health and sexual habits, as well as to monitor minors as young as 13 thought "susceptible" to disrupting public order. A new version, under review, would tighten the rules on who can be spied on, and what can be recorded. This would make an agent's job more professional, if less colourful. Either way, the surveillance culture will remain.

The euro

Seeking shelter

Oct 30th 2008
From The Economist print edition

Countries outside the euro zone are worried, but joining may not be easy

SHARING a currency but not a government—the hybrid arrangement for the 15 countries that use the euro—may look less than ideal in times of turmoil. But from the outside, the single currency looks like an increasingly attractive shelter.

Even solid ex-communist countries such as Poland want to speed up their preparations to meet the conditions for joining the common currency. And rich EU members that stayed out by choice, Sweden and Denmark, are thinking again. Joining the euro, at least in some eyes, means a loss of national identity. It also means governments cannot devalue or change interest rates to suit economic needs. During the sunny financial weather of the past years, that seemed to argue for staying out. The balance of the argument is now changing.

Denmark twice raised interest rates in October to help protect its currency, the krone, which is pegged closely to the euro. Sweden's krona fell to a record low against the euro in October as the central bank there cut interest rates in the hope of fending off a recession. The Danish prime minister, Anders Fogh Rasmussen, says that being outside the euro zone during the financial crisis is "detrimental" to the economy, and he wants a referendum by 2011. Even in non-EU countries, such as Iceland, adopting the euro is now a hot topic.

In eastern Europe, meanwhile, Slovenia has already adopted the euro and Slovakia will do so by the end of the year. But no other country looks close. Standard & Poor's this week cut Romania's credit rating to "junk" status, blaming politicians' irresponsibility about public-sector wage increases. Poland, ambitiously, says it wants to meet the criteria and set a fixed rate for the zloty against the euro in 2011. The government is now seeking cross-party support for the necessary constitutional amendments.

To join the euro, countries are required to have inflation and budget deficits at sustainably low levels ("low" is an average based on other countries' performance). In past years, eastern European countries have missed that because roaring growth pushed up prices. Foreign investment is likely to fall sharply. Soaring tax revenues once shrank budget deficits—but now the tax take is falling, exposing unreformed public finances. In Poland, these include wastefully untargeted social benefits such as early retirement.

Talking about a quick move to the euro may be a good gimmick for politicians, but the practical difficulties are huge. The countries of the euro zone are not longing for troubled new members; its existing ones, such as Greece and Italy, are worry enough. The higher taxes and lower spending needed to satisfy the entry criteria are not the choices that a country would normally make in a recession.

The prospect of euro membership in three years' time is unlikely to calm panicky financial markets now. That requires, at a minimum, large quantities of cash—as seen in this week's bail-out of Hungary (see article). This week the European Union said it would raise its own rescue fund from €12 billion ($15 billion) perhaps to €25 billion. Yet even with such outside help, running an independent currency is beginning to look too risky for all but the biggest economies.

Croatia

Still a Balkan country

Oct 30th 2008
From The Economist print edition

A spate of murders damages Croatia's European ambition

IT WAS, said one commentator, a "danse macabre" of Croatian society. On October 27th about 1,000 people attended the funeral of Ivo Pukanic, the editor of *Nacional*, one of Croatia's most influential weekly papers. He and a colleague had been murdered by a car-bomb in central Zagreb four days earlier.

Stipe Mesic, Croatia's president, was there to honour his friend along with government ministers. With Croatia's hopes of joining the European Union in 2011 now in jeopardy, he immediately promised an unrelenting campaign against criminals, terrorists and the mafia. It is "them or us", he said.

Yet convicted criminals and the family of Croatia's most notorious crime boss, Hrvoje Petrac, were also at the journalist's funeral. Mr Petrac is in prison for kidnapping the son of General Vladimir Zagorec. The general was extradited from Austria on October 2nd on charges of stealing gems used as collateral in an arms deal during the Balkan wars of the 1990s. Four days later, his lawyer's 26-year-old daughter, Ivana Hodak, was killed.

These murders have exposed Croatia's murky and violent underworld. Mr Pukanic, a gifted journalist, operated in the Balkan twilight zone where criminals, politicians, intelligence officers, journalists and lawyers meet to do business. Many corrupt businessmen and politicians have been the targets of *Nacional*, but many were not. The newspaper was close to President Mesic, whereas Croatia's other main weekly, *Globus*, tends to ignore him.

Mr Pukanic's targets were not just confined to Croatia. In 2001 his paper published a series of allegations linking leading politicians in other Balkan countries to smuggling and organised crime. These were republished in an opposition paper in Montenegro. In 2004 the editor of that paper was also murdered.

Much of Croatia's public would have welcomed a declaration of a state of emergency and the arrest of thousands of suspects, as happened in Serbia after the murder of Mr Djindjic in 2003. Instead Ivo Sanader, Croatia's prime minister, has taken a more measured approach: he has replaced his ministers of justice and interior, as well as the chief of Croatia's police. The authorities have announced special courts to deal with organised crime and better witness-protection programmes. Dozens of people have been arrested, among them four suspects in Mr Pukanic's murder, according to state television.

In terms of violence and corruption, Croatia compares well with other countries in the region, such as Bulgaria and Serbia. Yet the latest murders reveal a rottenness at the heart of a country better known nowadays for the beauty of its coast. "We pretended, even to ourselves, that we were always better than everyone else in the Balkans," says Ines Sabalic, a Croatian journalist in Brussels. "Now this makes us seem as if we were only richer and had more sun."




Charlemagne

Europe's baleful bail-outs

Oct 30th 2008
From The Economist print edition

State aid to failing industries will benefit politicians' favourites, not European citizens

Illustration by Peter Schrank



THE cigar-chewing plutocrat—that old standby of political cartoons—is enjoying quite a comeback. In *Le Monde,* a French daily, such tycoons have become a front-page staple, portrayed naked apart from the odd bow-tie. One Belgian newspaper*, La Libre Belgique*, showed a boss with cigar and top hat plunging to his doom after being stripped of his golden parachute by the Belgian prime minister (drawn as a flying Superman).

You get the idea. The "dictatorship of the markets" is dead, to quote Nicolas Sarkozy, the French president, replaced by "political" leadership and an acceptance of the need for "massive" state intervention; after aid for the banks it is time to help companies and protect jobs. On October 23rd, he unveiled a "strategic national investment fund" that will buy stakes in French industries with borrowed money to protect them against foreign predators. When markets rise, he said, the state will sell its stake and make a profit—as happened after the 2004 bail-out of the Alstom engineering group. Still, Mr Sarkozy's confidence is impressive. Is he certain his ploy will make money? And if he is, can we all have his stockbroker's number?

In Italy, meanwhile, Silvio Berlusconi has been rejoicing over the new vogue for government subsidies. Only a short time ago, he recalled, state aid was viewed as "on a par with mortal sin"; now it was "a categorical imperative". Even Britain wants to pour public money into bits of the economy that "make a difference". The rush to meddle is not uniformly welcomed. Germany's economics minister, Michael Glos, said Mr Sarkozy's call for governments to take stakes in key industries went against "all successful principles of our economic policy". And indeed, there are good economic reasons to be wary of intervention; history has not been kind to companies run by state planners.

In truth, few governments have money for meddling. Most intervention promised for the real economy so far has been virtual, repackaging existing spending. But where it takes place, such populism will be a problem if it undermines the core EU principle banning subsidies that distort competition within Europe. This underpins one of the greatest achievements of the European project—the single internal market that links 27 variously rich, poor, small and large countries, by creating a level playing field for trade between half a billion people. Weaken rules against state aid and you risk a damaging "subsidy race" between neighbours, says the EU competition commissioner, Neelie Kroes.

Even before the crisis, several governments chafed against EU competition rules. In 2007 Mr Sarkozy had a reference to "free and undistorted competition" deleted from the EU's proposed new rule book, the

Lisbon treaty, to appease French voters who think the EU is too market-orientated. In French political rhetoric, competition is a harsh doctrine whose opposite is *solidarité*.

Critics are not likely to be won over, in the depths of a crash, with economic arguments about the efficiency of markets. So here is a political argument: the opposite of competition is not solidarity, but monopolies and the maintenance of privilege. Politicians present themselves as disinterested guardians of the public good, tempering the power of the greedy, reckless capitalist elite. But in truth, too much state spending involves taking money from the many, who pay taxes and consume goods, and handing it to the few: ex-state monopolies, special interests, regional favourites or incumbents. As a rule of thumb—call it the Richard Scarry rule—politicians will rarely challenge interests that feature in children's books: such as farmers, fishermen, firemen and those that build exciting things. Mr Sarkozy told the European Parliament recently that EU leaders had a duty to ensure Europe could "continue to build aeroplanes, boats, trains and cars".

EU regulations are pretty good at rooting out the worst forms of pork-barrel spending (better, in many cases, than the equivalent rules in America). Competition officials in Brussels have long been pursuing two loss-making airlines, Alitalia and Olympic, over illegal subsidies. Both are tragedies born of patronage on an epic scale. For years, decisions about hubs and route maps have been dictated by politicians and trade unions trying to preserve local fiefs. Their payrolls have been bloated by the appointment of mistresses of the powerful, their in-laws and idiot nephews.

Privatisation and restructuring now await these flag-carriers. A similar fate is being pushed by Brussels on a set of Polish shipyards, which lose money on every ship they build (quite an achievement, during the recent shipping boom). Polish taxpayers could have several new schools and hospitals for the funds given to the shipyards over the years. But these are the birthplace of the anti-Communist Solidarity trade union, and Polish politicians are scared to challenge it.

Please restrain me

Mario Monti, a former EU competition commissioner, recalls how finance ministers would often visit Brussels, begging him to rule against subsidies they had promised to some local company, perhaps in the heat of an electoral campaign. They were "delighted" whenever he promised to block the state aid—with the understanding that, of course, they would condemn the commission's move in public. "I am sure they do the same today," says Mr Monti. If this crisis deepens, he says, EU competition policy, especially when it comes to policing mergers, can only become more important. Yet he thinks Mr Sarkozy also has a point: politicians must be seen to protect ordinary citizens to prevent a backlash against globalisation and the markets.

Squaring that circle will be hard. An increase in political meddling in the economy is inevitable. But politicians should not pretend they will be acting in the interests of all whenever they open the money tap. The cigar-chomping tycoons of political cartoons have real-life equivalents: oligarchs, monopolists and the operators of cartels. And their closest friends are often politicians.

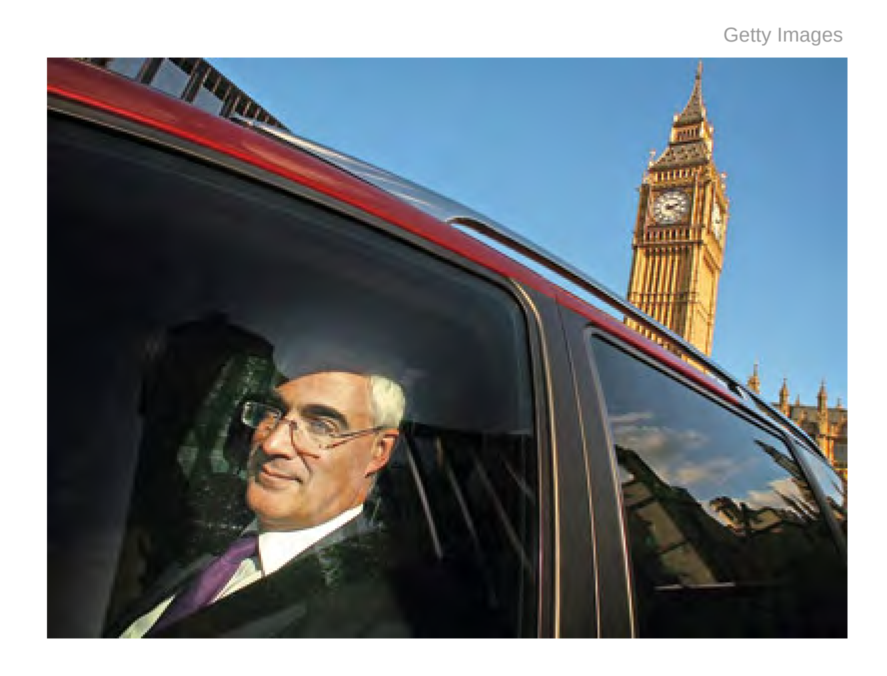
Public finances

So long, Prudence. We had fun but...

Oct 30th 2008
From The Economist print edition

Alistair Darling pragmatically gives himself more fiscal leeway, but he remains constrained by Gordon Brown's past profligacy

Getty Images



THE government had done its best to prepare the ground but it was still a humiliating moment. For over a decade Labour's fiscal rules, first set out by Gordon Brown when he became chancellor of the exchequer in 1997, had been the supposed lodestar for budgetary policy. But on October 29th Alistair Darling, his successor at the Treasury, in effect scrapped them for the foreseeable future.

Understandably the chancellor was not so explicit. More than most, he knows how galling it must be for Mr Brown to have to admit the demise of his fiscal pride and joy. But in a lecture at the Cass Business School in the City of London, Mr Darling ran up the white flag, saying that "to apply these rules rigidly in today's changed conditions would be perverse".

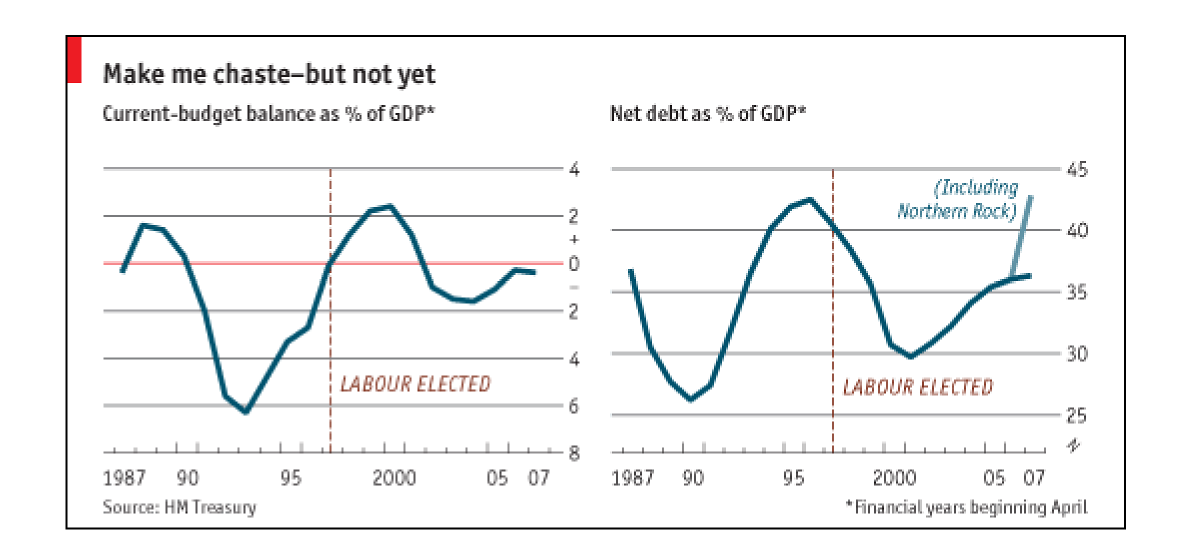
The chancellor did his best, blaming "unprecedented global shocks" for the government's change of heart. These meant that "we need a new approach that is fit for these new times". The priority for the moment, he said, was to provide support for the economy. Reducing borrowing and debt would have to come later.

No one doubts that these are extraordinary times, still less that the financial crisis is global in extent. But Mr Darling's explanation was as much an excuse as a reason. Labour's fiscal framework was in tatters well before the downturn now afflicting the economy.

That framework comprised two rules, adopted to bolster Labour's budgetary credibility after a long period in opposition. First, the Treasury would borrow only to invest over the course of the economic cycle. Put another way, the government's current-budget balance (which excludes net investment) would be in balance or surplus—a stipulation often called the "golden rule". And second, public-sector debt (net of liquid assets like foreign-exchange reserves) was to be held at a sustainable level, subsequently defined by the Treasury as below 40% of GDP.

The golden rule was the first to fall into disrepute. After some bumper years when the current budget was in surplus, it swung back into the red in 2002-03 (see first chart). But Mr Brown was able to disregard this because he had to meet the rule only over the economic cycle. That allowed him to offset

the new deficits with the previous surpluses. Crucially, the Treasury determined the dates of the cycle, which proved conveniently elastic—pushing its starting-point back to encompass more of the good years as the public finances got worse.



But if the golden rule could be fudged for a while, a breach in the debt rule proved more difficult to disguise, even though Mr Brown did his best to keep underlying public obligations off the books. Public debt has already risen above 40% owing to the decision by official statisticians to include the liabilities of Northern Rock, a mortgage lender nationalised in February (see second chart). The Treasury has decided that such liabilities should be excluded in assessing the rule, but this judgment no longer matters. Public borrowing is already ballooning. Even without the liabilities of Northern Rock and other banks rescued by the government, public debt is clearly going to smash through the 40% ceiling as tax revenues swoon and welfare spending rises.

For those expecting detail on what will replace the old fiscal framework, Mr Darling's lecture was a let-down. That will be left to the pre-budget report later this year. The chancellor will plainly want to give himself as free a hand as possible during the downturn while insisting on his determination to make amends when the economy recovers. Either way, at the election he will have to defend a sorry tale of soaring borrowing and indebtedness.

If the public finances that Mr Darling inherited last year had been in good shape, this cyclical reverse would have been more manageable. The chancellor insists that the fiscal rules had been met in the last economic cycle, which the Treasury believes ended in 2006-07. But that only shows how inadequate the rules were in constraining Mr Brown once he abandoned his early caution. He left the nation's finances in a mess, with deficits persisting even though the economy had been booming. Last year Britain's deficit as a share of GDP was among the highest in the 15 old members of the European Union.

Mr Darling does his best to put a favourable gloss on Labour's performance, pointing out that Britain has one of the lowest levels of debt among big economies. However, such international comparisons flatter to deceive. For one thing, they leave out liabilities that have been piling up through the "private-finance initiative", in which public investments, such as new hospitals, are paid for by private investors but where the money has to be repaid by taxpayers. Even more important, they leave out the government's generous unfunded pension arrangements for public-sector workers. Were these obligations included, they could easily double Britain's public debt.

Mr Brown's past imprudence has given his successor less budgetary leeway to boost the economy than he might like. For the moment the Bank of England has plenty of scope to help the economy by cutting the base rate, which currently stands at 4.5%. Yet even deep cuts will help less than usual to cushion a recession caused by snarled-up credit markets and banks scared witless. That is why there is a respectable case for using fiscal policy actively to counter the downturn, since that will increase demand directly, either through tax cuts or higher public spending. The shame of it is that even after Mr Darling's retreat there is less scope to administer such help than would have been possible if Labour had managed the public finances better in the good times.

Sterling's pounding

Back to earth

Oct 30th 2008
From The Economist print edition

Why has the pound tumbled?

ONE of the most striking aspects of the decade before the credit crisis was not just the strength of sterling but its stability. As recently as last November, Mervyn King, governor of the Bank of England, claimed that anyone searching for a stable trade-weighted exchange rate “couldn’t do better than look at sterling”. But in the past year the pound has been anything but stable as it has lurched down, most recently against the dollar.

In July New York shopping trips and American holidays were still in vogue for Britons as sterling remained around $2. By September the pound was trading around $1.80. In recent weeks the decline has been stomach-churning as the pound tumbled to a closing price of $1.55 on October 27th, although two days later it bounced back, ending at $1.63.

Sterling’s fall against the dollar followed, and has now overtaken, an earlier fall against the euro in late 2007 and the early part of this year (see chart). Together they have driven down sterling’s trade-weighted index (in which the dollar has a weight of 16.6% compared with the euro’s 53.1%) by some 15% in the past year. This index has been at its lowest point since late 1996, shortly before Labour won power.

Gathering gloom about Britain’s deteriorating prospects has contributed to the collapse of sterling against the dollar. The pound took a bashing on October 22nd, following a pessimistic speech by Mr King the evening before. It then suffered another relapse when GDP figures released on October 24th showed that the economy had contracted by 0.5% in the third quarter, a much bigger dent than expected.



Currency dealers immediately interpreted Mr King’s pessimism and the poor GDP figures as evidence that the Bank of England would bring down interest rates more aggressively. The central bank’s monetary-policy committee, which lowered the base rate on October 8th by half a percentage point, is expected to match or surpass that when it meets on November 6th. This is removing the support to the pound from relatively high interest rates.

Sterling may be on the ropes but it is not alone there. Over the past month the euro has fallen as steeply against the greenback. As David Bloom, a currency strategist at HSBC, a bank, points out, there has been a general rally of the dollar and the yen. And while the pound has fallen in the past month against these resurgent currencies, it has risen against others such as the Australian and Canadian dollars.

The pound’s sudden fall against the US dollar has been shocking, but it came from a giddy height. Sterling was overvalued at $2, a rate it has rarely held for long in the past two decades. It has now fallen to a more realistic level approaching purchasing-power parity—the exchange rate that would equalise prices in America and Britain—which the OECD estimates is $1.50.

In normal times the inflationary impact of a sudden decline of the pound would prompt angst at the Bank of England. But oil prices have collapsed and inflation expectations among the public fell sharply in October, according to a poll by YouGov for Citigroup, a bank. In these circumstances sterling’s weakness will not prevent the bank from delivering a big rate cut.

Bank regulation

Behavioural finance

Oct 30th 2008
From The Economist print edition

Can the government change the banks' business model?

PITY the bankers. They are struggling to hang on to their businesses and salaries—in the teeth of a public that would dearly like to see them don hair shirts, and a government that would like to turn banks into cash machines to keep home-owners and small businesses afloat. And because the government will soon be a significant shareholder in British banking, owning close to half of a merged Lloyds and HBOS, and an even bigger share of the Royal Bank of Scotland, the state looks as if it has the upper hand.

But will it be able to influence banks' and bankers' behaviour as much as it would like? One of the conditions of the government's £50 billion ($82 billion) bank-recapitalisation scheme is that bankers moderate their pay. The Financial Services Authority (FSA) has weighed in too, warning bosses earlier this month that it would look askance at pay deals that reward short-term profit-seeking. Another bail-out condition is that banks make lending available to homeowners and small businesses at 2007 levels.

As the economy worsens, bailed-out banks worry that if they must treat defaulters with kid gloves and keep lending, their balance sheets will take a further hammering. Those that have eschewed government capital, meanwhile, fear being undercut by artificially cheap loans.

The Bank of England's Financial Stability Report, published on October 28th, suggests that far from maintaining last year's lending levels, banks will have to shrink their balance-sheets by perhaps a sixth, despite the recapitalisation scheme. A gap of around £700 billion between customer deposits and loans, until recently bridged with wholesale funding mainly from abroad, means that unless they can attract more savings they will have to cut lending.

But that will mean more businesses going to the wall and more people losing their homes. Figures from Experian, a credit-scoring outfit, show a 28% increase in business failures in the third quarter compared with a year earlier. House repossessions totalled 18,900 in the first half of 2008, up 50% from the same period last year. Northern Rock, rescued and now owned by the government, is said to be among the most aggressive in turfing mortgage defaulters on to the street.

The chancellor, Alistair Darling, says the government is not in the business of running banks. Indeed, even with government-approved representatives on their boards, the big banks cannot duck the demands of regulators. The European Union's capital-requirements directive is about to get tougher: it may set a crude ratio for capital to gross assets and require more capital for assets held for trading.

These new rules, together with the government's own legislative reforms, are likely to increase the cost to banks of borrowing cash. Under a proposed special-resolution regime, after the FSA has declared a bank at risk of failure, the Bank of England can intervene and choose to divide good assets from bad. Banking lobbyists argue that uncertainty over which category their claims would end up in will spook creditors and make them less likely to lend on affordable terms. (The Treasury, though, says creditors would be no worse off than in a normal insolvency.)

The government, and bankers too, must accept that banks will not have the access to cheap private funding they enjoyed 15 months ago. Moreover, securitisation, which allowed banks to repackage and sell loans to lighten their balance-sheets, has fallen into disrepute. Rather than being engines of economic growth, banks are likely to be cost centres for some time to come.

A Scottish by-election

Political bubbles

Oct 30th 2008 | GLENROTHES
From The Economist print edition

Gordon Brown puts his new-found popularity to the test

PA



Excuse me, can I borrow some money again?

SOMEBODY'S bubble is going to burst at the end of this campaign, says a cheery Conservative campaigner in Glenrothes, where Scotland's four main parties are limbering up for a by-election to Westminster on November 6th. The remark sums up what is at stake in this battle: the reputations and perhaps the careers of Gordon Brown, Britain's prime minister, and Alex Salmond, Scotland's first minister and leader of the Scottish National Party (SNP).

Since his handling of the financial crisis converted Mr Brown from lame duck to global statesman, thoughts of losing Glenrothes, close to his Kirkcaldy seat, have receded and Mr Brown has pitched himself into the fray. And ever-present on the stump is Mr Salmond. Having gained power against the odds in the 2007 Scottish Parliament elections, and won an even less likely victory over Labour in the Glasgow East parliamentary by-election in July, he now hopes to achieve what would have until recently seemed impossible. Glenrothes has been staunch Labour territory since 1918, apart from electing a Tory in 1931 and then sending a Communist between 1935 and 1950.

Mr Salmond's optimism is not misplaced. Although Labour's John MacDougall, whose death caused the contest, held his seat in 2005 with a majority of 10,664 votes, in 2007 the SNP won power from Labour on the local council. They took the nearby Scottish parliamentary seat of Central Fife from Labour at the same time.

To reverse the Nationalist tide, Labour has gone negative, arguing that the SNP government's plans to replace the property-based council tax with a 3% local income tax will cripple households with two people in work. It also lambasts the council for raising charges for home help for the disabled, an accusation raised angrily at a hustings on October 28th. But at that meeting it also became clear that Labour's new-found trump card—the argument that an independent Scotland could not have afforded the bank bail-out—may be more deuce than ace. To applause, a questioner demanded to know what bail-out ordinary families were going to get, a tune the SNP are playing relentlessly in relation to soaring energy bills.

The campaign is a hard grind for both main contenders—roadside posters have been banned and only limited voter contact is permitted in the main shopping mall. "It's hard to get any momentum going," says an SNP staffer. Labour strategists worry that their more loyal voters in the small former mining and industrial towns circling the 1960s new town of Glenrothes may stay at home on polling day—as they did in Glasgow East. The Tories, who, like the Liberal Democrats, have no hope of winning, look chipper, though. A Labour loss next door to Mr Brown's constituency would check his recent rise. There is little love between them and the Nationalists, but both are hoping that it is the prime minister's bubble that is pricked.

The privileged Conservatives

Class worriers

Oct 30th 2008
From The Economist print edition

The Tories could do with looking less posh. Their options are limited

“CORFU-GATE”, the semi-scandal involving a pair of British politicians who accepted the hospitality of a Russian billionaire on his yacht in August, looked set to embroil both main political parties in a murky *cause célèbre* with potentially explosive consequences. Instead it is fading away, and no heads have rolled.

On October 25th Peter Mandelson, the business secretary, admitted that he first met Oleg Deripaska, who is barred from entering America, in 2004—two years earlier than he had first indicated. But he rejected the notion that his relationship with the metals tycoon led him to push for lower aluminium tariffs when he was the European Union trade commissioner.

Similarly George Osborne, the shadow chancellor, alleged to have solicited an illegal donation from Mr Deripaska for the Conservative Party, will not be investigated by the Electoral Commission or parliamentary authorities. On October 27th he confessed to having made a mistake and forswore any future role in fund-raising, but he denies that he broke any rules.

No scalps, then, but the controversy could still have an enduring impact. It exposes the risk taken by Gordon Brown, the prime minister, in reviving Mr Mandelson’s cabinet career in early October. Mr Mandelson twice had to resign from Tony Blair’s government after scandal, though he was cleared on the second occasion.

For the Conservatives, the implications of Corfu-gate may be more profound. The poshness of leading Tories has not been fatal to the party’s appeal so far: David Cameron, their leader, is likely to be the next prime minister and Boris Johnson, another old Etonian, was elected mayor of London in May. But the spectacle of a privileged Tory politician mixing with the super-rich during an economic downturn—not to mention the re-publication of photographs of him in the lordly garb of an exclusive student dining club—has encouraged the view that the Conservatives are cocooned from the travails of real life.

The Tories point to senior figures in the party who are hardly aristocrats, such as William Hague and Michael Gove on the front bench, and advisers like Andy Coulson and Steve Hilton behind the scenes. But they know that the class question may dog them as more voters struggle to make ends meet. They avoided champagne during the party’s recent annual conference, and a cringeworthy photo-feature of budding Tory MPs in the *Tatler* (a posh people’s magazine) is unlikely to be repeated.

Yet prospects for a Conservative Party that reflects Britain’s social mix are bleak. Many Tories would like to see the return to the front bench of the gritty David Davis, who quit as shadow home secretary in the summer to campaign for civil liberties. Mr Davis came up through public housing and state schools, and is reckoned a generally heavier hitter than his privately educated successor, Dominic Grieve. But it would be hard for Mr Cameron to offer him a quick comeback without being seen to reward quixotic behaviour, and Mr Davis may not want it anyway.

Also mooted is the elevation of Eric Pickles, a plain-speaking northerner, to the role of party chairman if a vacancy arises, as seems possible. But Mr Pickles is thought to be less popular with some of the party’s high command, who believe he hogged the credit for the Tories’ by-election win in Crewe and Nantwich in May, than with the party’s base.

The medium term looks little brighter, for the next intake of Tory MPs will contain many of gilded provenance. In the long term, however, the party could change its social mix by putting as much effort into recruiting parliamentary candidates from humble backgrounds as it has into finding women and members of ethnic minorities. Tim Montgomerie, who runs Conservative Home, an influential website, suggests more financial assistance for those who cannot afford the costs of a parliamentary bid. That would be a start.

Prison building

Icebergs ahead

Oct 30th 2008
From The Economist print edition

Plans for titanic new prisons sail into uncertainty

ANYONE looking for a recession-proof investment could do worse than turn his attention to the criminal-justice industry. As the economy slows and people lose their jobs, brawling and burglary tend to become more common. This downturn is already grim for housebuilders, but the coming months could be heady times for prison builders.

Demand for jail places is already bumping up against supply, thanks to the extravagant use of custodial sentences in recent years. The prison population has grown from 61,000 to 83,000 in the 11 years since Labour came to power in 1997, continuing a trend that began under the Conservatives. Even before the economic slowdown, prisoner numbers were projected to reach 95,000 by 2014; few would now be surprised if they turn out higher still.

Under plans announced in December, some of the new jailbirds are to be held in three new “Titan” prisons accommodating 2,500 inmates each—five times as many as most British jails can take. Penal reformers, as well as the government’s chief prison inspector, were opposed, arguing that big prisons in other countries have proved ungovernable and bad at getting prisoners back on the straight and narrow. The governor of Fleury-Merogis, a jail near Paris that can hold 3,800 inmates, warned Britain to think twice. Undaunted, the government insisted that, as well as being cheaper (thanks to economies of scale), the Titans would be more effective. They could offer more rehabilitation programmes (from drug treatment to vocational education) and allow prisoners to spend more of their sentence in one place, instead of being repeatedly moved, as many are now.

But enthusiasm for big prisons now seems to be cooling. Following the bad publicity at the time of their launch, the very name Titan has been banned inside the Ministry of Justice. In a speech on October 27th Jack Straw, the justice secretary, skilfully avoided using the word, instead referring to the jails as “large prison complexes”. (He also criticised penal reformers for not being plain-spoken.) In the same speech, surprisingly, he appeared to admit that Titans would indeed be inferior to small jails. Given more money and enough suitable sites, “I’m quite clear that 15 prisons with 500 prisoners might be a more attractive proposition than three prisons with two-and-a-half thousand,” Mr Straw said, adding that if someone could obtain planning permission and square the costs for small jails then “no one would be happier than me”. Officials insist that, with money tight and planning permission hard to come by, Titans are still the only option. But previous claims that they are superior seem to have been dropped.

So a big political question hangs over the Titans’ future, especially given that the Conservatives, who are favoured to win the next election, are against them. They say that smaller prisons could be financed by selling off the Victorian jails that lie on expensive city-centre land. (The government retorts that the Tories have got their sums wrong.)

It was once assumed that the Titan deal would be sealed before the next election, which must be held by June 2010, but time is running out. Almost a year after their announcement, firm plans for the big prisons are finally expected in the next couple of months. A competition to pick a firm to build (and possibly run) them will then begin. One prison builder reckons it will take a year to select a preferred bidder, and perhaps another four months to complete the contract. Signing the deal before the country goes to the polls could be a nail-biter.

Intelligence

Dimming

Oct 30th 2008
From The Economist print edition

Disturbing evidence of a decline in youngsters' brainpower





The hands-on way to budding minds

EVERY year Britain's school-children provide gratifying evidence of their increasing smartness. More leave primary school having done well in tests of reading, writing and arithmetic; more get top grades in national exams at ages 16 and 18. Nay-sayers, though, think this progress overstated, even illusory. They attribute rising marks to dumbed-down curricula, downward-drifting grade boundaries and teaching to the test. But even the gloomiest assessment, it appears, may not go far enough. In important ways, the country's children appear to be becoming dumber.

Michael Shayer of King's College London has been testing children's thinking skills since 1976, when he and colleagues started studying the development of reasoning abilities in young people. In 2006 and 2007 he got 14-year-olds to take some of the same tests as 30 years earlier. The findings, to be published early next year, are sobering. More than a fifth of youngsters got high scores then, suggesting they were developing the ability to formulate and test hypotheses. Now only a tenth do.

The tests did not change, so the decline was not caused by different content or marking. And since they explored the ability to think deeply rather than to regurgitate information or whizz through tasks, the results matter deeply. In the purest test of reasoning, pupils were shown a pendulum and asked how to find out what affects the rate at which it swings. "Their answers indicated whether they had progressed from the descriptive thinking that gets us through most of our days, to the interpretative thinking needed to analyse complex information and formulate and test hypotheses," Professor Shayer explains.

In 1976 more boys than girls did well, a fact the researchers put down to boys roaming further out of doors and playing more with tools and mechanical toys. Both sexes now do worse than before, but boys' scores have fallen more, suggesting that a decline in outdoor and hands-on play has slowed cognitive development in both sexes. Britain's unusually early start to formal education may make things worse, as infants are diverted from useful activities such as making sand-castles and playing with water into unhelpful ones, such as holding a pen and forming letters.

British children's schooling may be hampered, too, by the tests that show standards rising. These mean teachers' careers depend on coaching the weakest, rather than on stretching all children, including the most able. This interpretation is supported by another, more positive, finding from the research: that fewer children do very badly now than did 30 years ago.

When asked to speculate further on why fewer British teenagers now display mature reasoning, Professor Shayer eschews local explanations and puts the blame squarely on television and computers. They take children away from the physical experiences on which later inferential skills are based, he thinks, and teach them to value speed over depth, and passive entertainment over active. That chimes with other researchers' findings of cognitive gains on tasks that require speed rather than close reasoning—useful,

perhaps, as the pace of life accelerates, but hardly a substitute for original thought.

So what of children elsewhere? Britain's are not the only ones kept inside for fear of traffic or paedophiles, or slumped in front of a screen for much of the day. "There is no similar evidence from elsewhere," says Professor Shayer. "No one has looked for it." Perhaps they should.

Bagehot

Snoek with a kumquat coulis

Oct 30th 2008
From The Economist print edition

How the British are likely to respond to economic hardship

Illustration by Steve O'Brien



IN 1947—amid rationing, fuel shortages, mass unemployment and, after a cryogenic winter, floods and drought—the British government introduced the snoek, a relative of the barracuda, to a hungry nation. It tried to convince sceptics of the imported fish's appeal with recipes such as "snoek *piquante*" ("4 spring onions, chopped; liquid from snoek; 4 tablespoons vinegar; ½ can snoek, mashed…"). A redoubtable correspondent told the *Times* that he had "the greatest respect for [the snoek] as an article of diet. It tastes like a mackerel, only more so."

During the "winter of discontent" of 1978-79, the city of Hull earned the sobriquet "the second Stalingrad". Pickets prevented chemotherapy chemicals leaving the docks for hospitals. Farmers dumped dead piglets outside the office of the hauliers' union.

Britain nurtures two utterly contradictory notions of its character in times of hardship. One is dogged, stoic, phlegmatic—the Britain of make-do-and-mend, of snoek and orderly queues outside half-empty shops, and the thwarted dignity of the "hunger marches" of the 1930s. The other image is of rout and chaos: strikes, riots, rubbish mountains in Leicester Square, the legendary bodies that went unburied, three-day weeks, devaluations and IMF bail-outs. Which of these historical archetypes might the recession of the late noughties most closely resemble?

Another country

The long spell of prosperity since the last downturn (in the early 1990s) means that Britain's performance in past recessions may offer only a limited guide to this one. A generation of young adults, a few of whom sit on the front benches in the House of Commons, has grown up believing that economic growth is eternal and inevitable, and that penury is principally a theme for the alternative rock songs of their adolescence. Relatively few people now remember the tribulations of post-war austerity, as many still did in the bruising 1970s. Lots of Britons these days would expect their snoek *piquante* to come with a kumquat coulis.

And in that long stretch of coddling, the British economy has been transformed. The labour market is more flexible, which ought to allow firms and workers to respond more nimbly. On the other hand, pensions provision has become patchier, and welfare rules stricter than they were in other post-war recessions, which may exacerbate the pain. Partly because the economy has changed, the shape of the recession will be different too.

The impact of the deep downturn of the early 1980s is still visible in ex-industrial towns: disused factories, dilapidated back-to-back housing and entrenched social ills. The incipient recession, by contrast, is decimating financial services and related sectors: bankers and consultants, but also retailers, restaurants, estate agents, personal trainers, dog walkers and purveyors of organic food. London will be hit at least as badly as anywhere else (200,000 Londoners may lose their jobs in the next two years, says one estimate). The young will likely fare worse than the old.

But for all those changes and provisos, some projections are feasible. One concerns the vexed concept of fairness.

The British are inconsistent about fairness. They loathe queue-jumpers and disparities in the standards of hospitals and schools; but they are more relaxed than other Europeans about inequality in income. They tell pollsters that they care about the poor, but are disinclined to pay more tax to help them. In particular, many see the jobless as shirkers and freeloaders, and think their benefits too generous. At least, that is the consensus that has evolved in the fat years. In leaner times, surveys suggest, attitudes are more charitable, and redistribution more welcomed.

One possible explanation for this variation (advanced by David Kynaston, a historian) is that Britons tend to espouse an enhanced version of fairness when it chimes with their self-interest. So, for example, they embraced the National Health Service not because it embodied an abstract collectivist ideal, but because it offered them cheap health care. Likewise, sympathy for the victims of economic misfortune may rise in recessions because more people have friends or relatives among them. On this basis it seems likely that the public may soon be amenable to measures designed to share the economic burden "fairly"—such as increased taxation of the very wealthy (especially since many are inclined to blame the City super-rich for their predicament, rather than, say, Gordon Brown or their own imprudence). Social democracy may make a mild and temporary comeback.

Another response anticipated by many—including the Home Office, according to a recently leaked memo—is a rise in anti-immigrant sentiment and ethnic tensions. The hardships of the 1930s did indeed turn some Britons against "foreigners"; there were race riots in the early 1980s. Immigration has risen massively since, and sympathy for far-right parties has spread among disgruntled working-class voters. Moreover, some immigrant communities are already restive, because of foreign-policy and anti-terrorism measures. So the ethnic pessimists may be right.

On the other hand, extremist parties and ideas failed to galvanise Britain even in the wretched 1930s. On past form, the main danger for politicians may be of embracing myopic short-term fixes with painful long-term consequences—such as the 1980s ruse of switching some of the jobless onto incapacity benefit to mask their true numbers, a distortion that Labour is only now seriously addressing. As for ordinary folk, both the iconic phlegmatism of the snoek era and the famous stand-offs of the 1970s are exaggerations of the humdrum norm: most Britons didn't march in the 1930s or riot in the 1980s; in the austere 1940s, many, eventually, dabbled in the black market. This time, economic woe will most likely lead neither to doughty heroism nor widespread tumult, but rather to grumpy disengagement: an accelerated and sullen withdrawal into private concerns; a quiet and further fraying of the democratic bonds in an already atomised society.

Policing prostitution

The oldest conundrum

Oct 30th 2008 | AMSTERDAM AND AUCKLAND
From The Economist print edition

The red lights are going out all over Europe—but not elsewhere

Corbis



WHEN the Netherlands legalised brothels eight years ago, the mood was upbeat. Politicians thought they were well on the way to solving one of the world's perpetual policy dilemmas: how to stop all the bad things that are associated with the sex trade (coercion, violence, infectious diseases) while putting a proper, and realistic, limit to the role of the state.

The Dutch were hoping that links between prostitution and multiple forms of crime, from money laundering to smuggling, could finally be severed. Ultimately, they believed, the buying and selling of sexual services would become a freely undertaken transaction, in which the state would only be involved as a regulator and tax-collector. The police could then concentrate on criminals, instead of harassing people engaged in exchanges that were nobody's business but their own.

While the Dutch experiment was beginning, another European country was trying out a different approach. From 1999 onwards, Sweden began penalising people who patronise prostitutes (through fines, jail terms of up to six months, and "naming and shaming"), while treating people who sell their bodies as victims.

All over the world—especially in rich democracies—policymakers have been watching the two places to see which philosophy works best. In reality, neither is a silver bullet; neither country has found a perfect way of shielding prostitutes from exploitation and violence, while avoiding a nanny-state. So the arguments rage on, from liberal New Zealand to San Francisco, where people will vote on November 4th on virtually decriminalising the sex trade.

In Amsterdam—where the spectacle of half-naked women pouting behind shopfront windows is a city trademark—the link between prostitution and organised crime has proved durable. Efforts to break it have been a "complete failure", says Lodewijk Asscher, a deputy mayor who has led the city hall's effort to buy up and transform much of the red-light district.

Fresh arguments in favour of his campaign emerged from a report published in July by Dutch police and prosecutors. It drew heavily on the case of three Turkish-German vice barons who were sentenced recently to long prison terms for running a ring of 120 prostitutes in three Dutch cities. Their operation included many of the ghastly practices that the liberal law was supposed to stamp out.

Saddled with fictitious debts, the women under the barons' control were made to take 20 clients a day,

subjected to forcible breast enlargements and tattooed with the names of their "owners". Such exploitation is not exceptional: the policemen who patrol Amsterdam's red-light district reckon that more than half the ladies posing in windows are there against their will.

All that helps to explain why the Swedish experience is finding imitators in several countries—including England and Wales where people will soon be liable to prosecution for "paying for sex with someone forced into prostitution…or controlled for another's gain". It is also becoming easier for English and Welsh police to prosecute people (either pedestrians or motorists) who solicit sex on the street. In Scotland, kerb-crawling was banned a year ago. The British moves were made after studying the Dutch and Swedish experience.

But what is really happening in Sweden? The policy of penalising clients or "johns" enjoys widespread consent. It was introduced by a centre-left administration, despite opposition from the centre-right. Now it is accepted by all Sweden's main parties. The authorities say the number of streetwalking prostitutes fell about by 40% during the first four years of the new regime. Swedish politicians say they have made their country a bad destination for traffickers. But a sceptic might retort that by driving prostitution away from Sweden, the authorities have simply exported it, sending sex-hungry Swedes to nearby countries or else to Thailand.

It's dark underground

Moreover, a sex-workers' association in Sweden says the law makes life dangerous for those who ply their trade secretly. A life of dodging between apartments and exchanging furtive texts can leave women more reliant on pimps. Another argument is that fear of prosecution reduces the chances that clients will report the exploitation of under-age girls or boys.

Some drawbacks of doing things the Swedish way have been noted in more established quarters. A report by Norway's justice ministry, in 2004, cited evidence of an "increased fear of attack" among Swedish prostitutes, who found it harder to assess their clients because transactions had to be agreed hastily or on the telephone. But for Norway, it seems, these considerations have been trumped by others, including a sense that prostitution is getting out of control after an influx from Africa, South America and eastern Europe. The Norwegian parliament is on the verge of mandating Swedish-style penalties for buying sex. In a similar spirit, Italy's cabinet has agreed to outlaw prostitution in public and make penalties harsher.

In Europe, then, things are moving towards tighter regulation—in part because many of the continent's richer countries feel inundated by a wave of newcomers to the trade, some of whom are trafficked. But there are other places where more liberal voices seem to be gaining the upper hand.

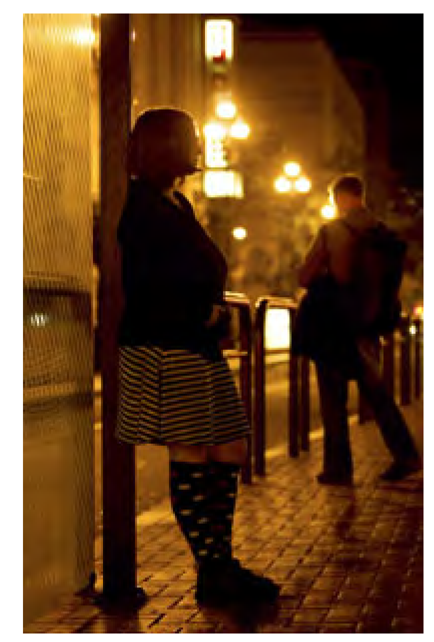
In the United States, trading in sex is a misdemeanour, at least, almost everywhere, with the exceptions of Rhode Island (where it can take place only indoors, but not in brothels); and, most famously and brashly, in parts of Nevada. So if residents of San Francisco vote for "Proposition K"—which would bar police from taking action against sex workers—it will be a landmark in American history.

AP

Supporters of the change (including sex-workers' unions) say it will transform the role of the police. Instead of pointlessly arresting prostitutes, the police can help them stay healthy and protect them from violence. Advocates of a "no" vote say that if the hands of the police are tied, they will be unable to deal even with obvious cases of abuse. Some say the Dutch experience has made nonsense of the case for liberalisation. Others say Proposition K could lead to a worse situation than the Netherlands': a free-for-all without the Dutch level of regulation and social security.

But for liberals in search of success stories, New Zealand appears to provide more promising evidence. In 2003, that country decriminalised the sex trade with a boldness that exceeded that of the Dutch. Sex workers were allowed to ply their trade more or less freely, either at home, in brothels or on the street.

A study published by the government in May, measuring the impact of the new law, was encouraging. More than 60% of prostitutes felt they had



more power to refuse clients than they did before. The report reckoned that only about 1% of women in the business were under the legal age of 18. And only 4% said they had been pressured into working by someone else.

The report also acknowledges one distinct advantage enjoyed by New Zealand. Although some illegal immigrants are engaged in the sex trade, the country's isolation and robust legal system make it relatively free from the problem of trafficking, at least by European standards.

But there is also a big difference between the policy of New Zealand and that of other places where prostitution is legal. In the Netherlands and Nevada, the business is confined to brothels, which are usually run by businessmen rather than the sex workers themselves.

Clearly, the brothel-masters' status as the sole legal providers of commercial sex enhances their grip on the women who work for them. In New Zealand, prostitutes can fend for themselves. As well as letting them keep all their earnings, this independence gives them freedom to reject nasty clients and unsafe practices. "They feel better protected by the law and much more able to stand up to clients and pushy brothel operators," says Catherine Healy, head of the New Zealand Prostitutes Collective.

Unsurprisingly, the New Zealand system's critics include brothel owners, both in that country and elsewhere. Going with a girl outside a licensed establishment is like "Russian roulette", says the website of the Chicken Ranch, a brothel that serves the Las Vegas crowd. In New Zealand, one brothel keeper fumes that the earnings of independent sex workers are "tax-free money, which is not benefiting the Inland Revenue Department".

What about other interested parties—such as respectable Kiwis who resent kerb-crawlers? According to polls, people are sure the number of prostitutes has risen—although the government says this is not true. Auckland city council is trying to allay public concerns by restricting brothels to commercial and industrial areas. Something similar happens in Nevada, where only the smaller counties may host brothels, and they are kept away from town centres. (Such curbs have some bad effects; prostitutes say they are stranded in the desert, totally reliant on brothel owners.)

In any case, one unusual investigation concluded that from the prostitutes' point of view, the New Zealand system was the fairest. A pair of British grandmothers from the Women's Institute—a homely club that is more often associated with cooking tips—made a tour of brothels in the Netherlands, America and the Antipodes: their aim was to find which system was best for the women who worked in the business. Their top marks went to a discreet house in a suburb of Wellington—classed in New Zealand as a "small owner-operated brothel"—where two women offered their services from Mondays to Fridays. "Just like a regular job," one of the grannies noted.

Fighting the nuclear fight

When nuclear sheriffs quarrel

Oct 30th 2008
From The Economist print edition

The job of keeping sensitive materials away from pariahs was always hard—and now it's marred by squabbles

Illustration by Claudio Munoz



NOBODY feels much natural love for a shadowy group of self-appointed policemen, engaged in a tough job which some outsiders resent. Yet there is one such band of brothers that does noble work. For more than 30 years, the effort to halt the spread of nuclear weapons has relied, at a practical level, on a small, publicity-shy bunch of officials from a club called the Nuclear Suppliers Group (NSG).

Behind closed doors, this 45-nation fraternity stitches up rules whose aim is to control trade in nuclear materials, equipment and technology. They don't always succeed. North Korea, Iran, (a subsequently reformed) Libya and others tapped into a nuclear black market that was run for years from Pakistan. But now the fraternity itself is under strain, with perilous consequences for world peace.

These problems have come at a bad time. Many governments are considering nuclear power plants, to cut greenhouse emissions and meet rising energy demand. It will take clearer, tighter rules on transfers to prevent technology sold for civilian nuclear purposes from being misused. Yet at a meeting this month, the NSG will be under strain in several ways.

One new source of strain is a statement by China, an NSG member since 2004, that it now plans to sell two new nuclear reactors to Pakistan. If that goes ahead, it will flout an agreed ban on nuclear trade with countries that do not have all their nuclear industry under international safeguards.

A second problem is the opposition of some NSG members, especially Canada and Brazil, to criteria proposed this year for curbing trade in the most sensitive nuclear technologies: those for enriching uranium or producing plutonium, materials that can be made into reactor fuel or, when refined, into the fissile core of a bomb.

The two issues have become linked because of a third row that has left tempers badly frayed. The last time the NSG met, in September, America pushed through an exemption to the nuclear-trade rules for India. This fulfilled a promise made by George Bush to India's prime minister, Manmohan Singh, in 2005 in an effort to cement a new friendship and help balance the rising influence of China. The American move drew open criticism from some NSG members and grumbles from others.

Like Pakistan and Israel, India has stayed outside the Nuclear Non-Proliferation Treaty (NPT), building nuclear weapons instead. Under NSG rules, none of the three should be entitled to import either civilian or military nuclear technology and materials. Like the others, India still bars inspectors from the

International Atomic Energy Agency (IAEA), the UN's nuclear guardian, from some of its nuclear sites.

Yet for the first time in decades, India's NSG waiver will enable it to import foreign fuel and other technology for its civilian nuclear industry: it is the only non-NPT country to get that perk.

Pakistan wants similar treatment, but there is no realistic hope of that. Its government has form in the proliferation business, although it conveniently blames an impressive series of black-market sales on one rogue scientist, Adbul Qadeer Khan. But China feels that if rules can be bent for India, America's friend, they can be broken for its own chum, Pakistan.

When China joined the NSG, it insisted that two reactors it said were already promised to Pakistan should still be built (the second is now nearing completion). Other NSG members reluctantly agreed, on the understanding that there would be no more nuclear sales to Pakistan. Drawing such a line was thought worth the price, as long as there really was a change in China's behaviour. There had been suspicions (later confirmed from drawings found in Libya) that in earlier times, when it was more careless about proliferation, China had actually given Pakistan the workable design for a bomb.

Laxity all round

By ending a period of self-restraint over sales to Pakistan, China is undermining the credibility of the NSG. But so are others. Two years ago, when Russia broke ranks, using specious "safety" arguments to sell fuel to India for two reactors that were running short, the Bush administration protested loudly. But recently, with their own India deal on the books, the Americans have been slower to denounce misbehaviour. This fuels fears that by creating an India-sized hole in the NSG's rules, America is causing the whole system to unravel.

Meanwhile, the row over India is having other ill-effects. It is complicating efforts to define criteria for the transfer of sensitive uranium-enrichment and plutonium-reprocessing technologies. India says it must now get "full" and "unrestricted" nuclear trade. Others disagree, noting that technology supplied for making civilian fuel could easily be misused by India to boost its stocks of fissile material too.

America's own laws already forbid it from selling India such technologies; indeed it is mandated to slap sanctions on any state that helps India in that way. Yet the Bush administration resisted efforts by some NSG members to write the necessary restrictions into the club's nuclear waiver for India; it used the argument that no country was thinking of supplying the Indians with that sort of technology.

Meanwhile, the effort to come up with global, proliferation-proof criteria, under way for at least five years, has run into problems. As part of an effort to push the India deal as quickly as possible through Congress, America's secretary of state, Condoleezza Rice, vowed to give "highest priority" to the effort to secure a decision at this month's NSG meeting. But to achieve that goal would require the sort of high-level pressure that got the India deal accepted, and there is no sign of that yet.

In 2004 George Bush had called for a global moratorium on transfers of sensitive technology to countries that did not already have fully functioning enrichment and reprocessing plants. The idea has since been endorsed by annual G8 summits (of the G7 group of rich economies, plus Russia). But this year the G8 dropped the idea.

For one thing, Canada objects. It has some of the world's largest reserves of high-quality raw uranium, and one of the best records in non-proliferation. It wants the option of profiting from any nuclear renaissance by acquiring the technology to enrich its own uranium for export, rather than leaving all the profits to countries with a foot in the business, like America, France, Japan and Russia—and India.

Brazil is another *refusenik*. Most other NSG members could agree on criteria for sensitive nuclear trade. For example: membership of the NPT (thus blocking such dealings with India); being in good standing with the IAEA (which rules out Iran); and the application of advanced IAEA safeguards under an Additional Protocol that countries are encouraged to sign. But Brazil won't sign the Additional Protocol. It has a pilot enrichment plant at Resende, and it is limiting the access that inspectors enjoy. This is supposedly to protect commercial secrets, and to uphold the idea that enhanced inspections are voluntary. Some suspect, however, that Brazil wants to hide the fact that some technology came through less-than-formal channels.

The NSG is meant to work by consensus. Frayed tempers, bruised feelings and the deliberate bending and breaking of rules that have taken years to create are now threatening to break the posse up.

Chief financial officers

In the eye of the storm

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From The Economist print edition

Have chief financial officers ever mattered more—or been less prepared?

Illustration by David Simonds



“THERE is no Armageddon scenario,” said Keith Sherin, the chief financial officer (CFO) of GE in an interview in July with 247wallst.com, a website. Two months later, Mr Sherin may have regretted his optimism. As the credit markets froze and investors panicked, he found himself embroiled in a frantic effort to stabilise the huge, triple-A-rated conglomerate. In the space of a few days, GE raised fresh capital from Warren Buffett and other investors; slashed its profit forecast; abandoned a share-repurchase programme; and paid extraordinary interest rates (for GE, at least) to meet its overnight financial needs in the commercial-paper market.

On October 27th GE became the first company to borrow from the Federal Reserve’s new Commercial Paper Funding Facility—not, the firm insists, because it is having difficulty borrowing, but to help get the facility going. Meanwhile, Mr Sherin is trying to reduce GE’s use of commercial paper (it is the world’s largest issuer).

Mr Sherin is not alone in his struggles, and few of his fellow CFOs have the luxury of working for such a financially strong firm as GE. Is there a CFO anywhere who has not been asked the most basic questions by the chief executive in the past few weeks—along the lines of “Have we got enough cash to make it through the night?” and “What are the chances of us going bust?” And now they must oversee the annual budgeting, with the economic outlook for next year anybody’s guess.

Even as they battle to stay afloat, many CFOs are haunted by past errors, thanks to an event almost as unexpected as the collapse of the financial system: the sudden reversal of the dollar’s seemingly permanent decline. A host of American exporters have seen their revenues fall alarmingly as the greenback’s rise revealed hedging policies ranging from the inadequate to the non-existent. More ominously, on October 20th CITIC Pacific, a Chinese steel and property company, revealed losses that could reach $2 billion, stemming in part from a derivative that hedged currency movements within a band that proved too narrow to protect its revenues.

Asian companies are more likely to suffer such derivative-related losses than European and (especially) American firms. These have been more careful about their use of the instruments in recent years because of the “keep-it-simple culture” fostered by the Sarbanes-Oxley act, says Wolfgang Koester, boss of FiREapps, a firm that provides exchange-rate risk-management software. That said, many American firms lack a thorough understanding of their foreign-exchange exposures, having had little incentive to acquire one when the dollar was falling. In the past two months they have increased their hedge ratio from 40%

to 55% of revenues earned abroad, but this mostly reflects hedging of rich-country currencies, ignoring the fact that exposure may be greater to more volatile emerging-market currencies, says Mr Koester.

Few of the CFOs grappling with this turmoil have ever experienced anything like it. Not many of them were in their jobs during the previous economic downturn, at the start of the decade. In common with chief executives, CFOs do not last as long as they used to. These days 25-30% of them move on each year, nearly twice the rate in the 1990s. This year, on average, the CFO of a *Fortune* 1,000 company has been in his job for just 30 months. Mr Sherin, GE's CFO for a decade, is a rare exception. And though he was promoted from within, a remarkable 40% of CFOs are hired from outside, and so are unlikely to know where the financial bodies are buried.

To their newness, add narrowness. In the late 1990s CFOs were increasingly hired for their expertise in capital markets and financial engineering, as shareholders and chief executives demanded ever higher short-term profits—paving the way for disasters such as the collapse of Enron and WorldCom, in which star CFOs Andrew Fastow and Scott Sullivan played central roles. However, this changed after Sarbanes-Oxley, when there was instead a "massive focus on people with technical accounting skills", says Eric Rehmann, head of the CFO practice of Korn Ferry, a recruitment firm. "There was a preference for people who had been financial controllers or certified practising accountants," he says. Audit committees wanted candidates with "technical experience and a track record, not breadth".

True, in the past few years many CFOs have seen their roles expand to include overseeing departments such as property, information technology and procurement, says Kurt Reisenburg, who heads the finance practice of the Corporate Executive Board, a support network for managers. But this was mostly about shifting the administrative burden from the chief executive, rather than playing the broader role in leading corporate strategy that Mr Reisenburg says is needed. "All these activities are cost-control focused, not about supporting growth decisions," he says. The few CFOs who have "learnt about operations, and have got relationships with key operating executives, are better placed than those who have focused on Sarbox compliance and financial engineering."

For example, the downturn will probably lead to tension between finance and sales in many firms—finance wants to keep prices high as commodity prices fall, whereas sales wants to cut prices to increase market share. A CFO who has spent time with the sales department, rather than just hanging out with the financial controller, is more likely to be able to resolve this conflict, says Mr Reisenburg.

There needs to be a return to the CFO's role as "manager of the company's balance sheet, overseer of corporate risk, insurer of the financial health of the enterprise", says Bill George, the former boss of Medtronic and author of "True North", a book on leadership. "A strong, conservative CFO is needed now more than ever, and should be given greater authority within the executive suite," he says, citing the roles of Don Humphreys of Exxon Mobil and David Viniar of Goldman Sachs. (Mr George is a director of both firms.)

As it happens, Mr Viniar is identified as the "most relatively highly paid CFO" in a recent paper by Graef Crystal, a compensation expert. (Mr Viniar took home $23.2m in 2007, according to Mr Crystal, though Salary.com reckons it was $42.2m.) As the American economy sinks, CFOs are "having to look at whole lots of unpalatable numbers. But there's one set of numbers they still find thrilling to examine: their own pay," observes Mr Crystal dryly.

Although they take home less than chief executives, CFOs can get rich fast. Sharilyn Gasaway, the CFO of Alltel, a phone company, is reportedly now the highest-paid female executive in America. Overall, "CFOs are enjoying larger pay gains than other C-level executives", concludes the latest annual review of compensation trends by *CFO Magazine*, a sister publication of *The Economist*. Median direct total compensation (base pay plus incentives) rose by 5.4% for CFOs in 2007, but fell by 1.4% for chief executives and by 1.7% for chief operating officers.

Still, CFOs face a lot just now. After the dotcom crash, more CFOs were fired than chief executives. If history repeats itself, the CFOs who survive to take home a fat pay packet will probably have earned it.

America's car industry

And then there were two

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From The Economist print edition

The combination of GM and Chrysler hinges on government support

Bloomberg



Seeking cover from the government

DESPERATE people do desperate things, which is why the odds are that a merger between two of Detroit's Big Three carmakers, General Motors (GM) and Chrysler, will somehow be made to happen. Certainly, the choices facing both firms are stark. At their current rates of cash burn, both firms will run out of money before the end of 2009, according to Rod Lache, an analyst at Deutsche Bank. GM, which has seen its sales in America fall by 18% this year, has about $20 billion in cash, but it needs to keep back at least $11 billion as working capital. Sales at Chrysler, which is owned by Cerberus Capital Management, have fallen by 25%, but it should have about $8 billion left by the end of this year. It too needs more than half that amount to finance its continuing operations.

Neither GM nor Chrysler is in any position to raise funds on commercial terms. Nor do they have assets that anyone else wants to buy. Chrysler's hopes that Carlos Ghosn of Renault-Nissan, always on the lookout for new automotive alliances, might provide it with an injection of capital were firmly rebuffed this week by Mr Ghosn himself.

Both companies are adamant that bankruptcy, a route well travelled by America's big airlines, would only make things worse. Car buyers, they say, will refuse to buy vehicles from companies that might not be around in the future to honour warranties and supply parts. As for the proposed merger (a euphemism for GM absorbing Chrysler), GM fears that some chunky restructuring costs will have to be met before it can realise a predicted $10 billion in annual savings.

Accordingly, any deal depends on the government stumping up most of the cash required to make it work. To that end GM's boss, Rick Wagoner, has been twisting arms in Washington, DC. He wants the Department of Energy to speed up the disbursal of $10 billion in loans to GM (approved by Congress as part of a $25-billion scheme supposedly intended to help carmakers shift to making more fuel-efficient vehicles). Meanwhile GMAC, the big lending firm jointly owned by Cerberus and GM, wants the Federal Reserve to let it become a bank holding company. This would make it eligible for a slice of the Treasury's $700 billion bank-bail-out fund.

All the signs are that GM and Cerberus will not be sent away empty-handed. David Cole of the Center for Automotive Research observes that the government is likely to conclude that if Chrysler is going down, "it's a lot better if it goes down in somebody's arms."

Companies and state aid

Helping hand?

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Will European governments' efforts to help firms do more harm than good?

ACCORDING to the accounts of Jérôme Frantz, director-general of Frantz Electrolyse, a family-owned car-parts firm in the suburbs of Paris, daily sales in October averaged €40,721 ($52,700), 25% lower than the average for the first six months of 2008. The company breaks even at €45,000 a day and, ominously, one of its suppliers just went bust. "I don't know what to do," says Mr Frantz, who does not want to fire any of his 170 employees.

He wants immediate help from the government to boost short-term access to credit, plus longer-term reforms to lighten the fiscal and regulatory burdens which handicap French industry. In asking for government help, however, European firms must be careful what they wish for. In the past governments have acted in ways which made things worse. After the oil shock in 1973, for instance, says Gayle Allard, an economist at IE Business School in Madrid, France made it harder to fire people by raising the mandatory level of severance pay. This week, echoing that era, France's President Nicolas Sarkozy issued a stern warning to businesses not to use the crisis as a pretext to fire people.

Having pumped vast sums of public money into banks, European governments are trying to encourage them to continue lending to businesses on favourable terms. In some places, such as Britain, this is being done by moral suasion only; elsewhere, as in Italy, banks may be forced to lend.

In France, says Laurence Parisot, head of Medef, the country's leading business organisation, the government will exercise a strong influence over banks' lending to firms. That worries Ms Parisot; banks, after all, are businesses too, and they need to make their own decisions on allocating credit. In seeking to help business, she says, the most important thing is that governments first "do no harm", for instance by raising taxes on firms.

Another unwelcome response to the crisis is for governments to try to protect firms from foreign takeover. On October 23rd Mr Sarkozy announced a "strategic investment fund" which would "intervene massively every time a strategic enterprise needs equity capital". The plan has been attacked both for its protectionist aim and for its heavy-handed intervention in industry. In Germany, similarly, business lobbies oppose a new law to shield firms from foreign takeover.

Individual industries are more than happy to accept other forms of state aid. Green technology, in particular, is proving a good pretext for handouts. This week European carmakers got the Commission's backing for their request for €40 billion in soft loans to help develop fuel-efficient vehicles. In Germany the electronics industry wants the government to subsidise households to buy new energy-efficient fridges. The construction industry is looking forward to a forthcoming stimulus package, to be spent on infrastructure.

In Italy, which like France has a recent past of large-scale state involvement in business, some industries have high hopes. UNRAE, the foreign carmakers' association, is calling for an increase in *rottamazione*, or scrapping, whereby the government offers households a financial incentive to trade in old cars for new ones. Michele Tronconi, head of Sistema Moda Italia, Italy's main clothing lobby group, hopes the government will put in orders for new uniforms for policemen, firemen and soldiers to help the textile industry.

One measure on which both business and governments seem to agree is late payment of suppliers. In Britain, for instance, many big companies have recently started paying even later than usual, says Miles Templeman, head of the Institute of Directors, which represents small and medium-sized firms. That can cause a potentially fatal shortage of cash for small firms. Governments, it seems, are even worse. Some private firms have to wait a full year to get paid by the state, says Emma Marcegaglia, president of Confindustria, Italy's leading business group.

What European firms want most of all is greater labour flexibility and a reduction in taxes and regulations. Mr Frantz is optimistic that the financial crisis will force governments to improve the overall environment for business. Others are not so sure. In June, as the oil price rose, the French government proposed forcing companies to pay for petrol for their employees' journeys to and from work, a move Medef is fighting to block. With friends like these, who needs enemies?

Aviation

Freedom's call

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From The Economist print edition

A new bid to liberalise the crisis-wracked airline business

Illustration by David Simonds



SUCH is the mess in the world airline industry that the halving of oil prices from their peak in July has brought only a modicum of relief. Fuel prices were high during the summer, the industry's busiest time, so airlines were unable to build up their cash reserves before demand weakens in the winter. And although the oil price has eased, the dollar has strengthened—which is bad for airlines outside America, since fuel and aircraft are priced in dollars. The onset of global recession will drive another 30 airlines out of business before the economy bottoms out, adding to the 30 that have already failed this year, predicts Willie Walsh, the boss of British Airways.

According to the latest figures released by IATA, the industry's trade association, international passenger traffic in September suffered an "alarming drop", falling by 2.9% compared with the same month last year. Cargo plummeted by 7.7%. Asia-Pacific carriers experienced a 6.8% fall in passenger traffic, and even Middle Eastern airlines, used to years of double-digit growth, contracted by 2.8%. In Europe and America, after a flat August, freight traffic nosedived by 6.8% and 6% respectively, the biggest declines since 2001.

IATA's director-general, Giovanni Bisignani, says the industry's cumulative losses this year are likely to exceed the organisation's earlier forecast of $5.2 billion; airlines in America alone will lose $5 billion. IATA is preparing for the worst. Twenty carriers are on its watch list, including more than one big network operator, and it has an 80-strong rapid-response team it can send in to prevent a failing airline from contaminating the complex international settlement system (used to transfer money between travel agents and airlines) that IATA runs for the industry.

That is not all IATA is doing. Mr Bisignani has long campaigned for the industry to be freed from the shackles that prevent airlines being run as normal businesses. In particular, he wants an end to the archaic rules governing market access and the restrictions on foreign capital that limit the ability of airlines to raise equity from international capital markets and inhibit cross-border mergers (other than in the European Union, that is, where Lufthansa of Germany this week moved to take over bmi, a British carrier). He believes it is more urgent than ever to cut through the web of 3,500 government-to-government bilateral agreements suffocating the industry.

With that aim in view, and with the support of its 230 member airlines, IATA invited 14 broadly pro-liberalisation governments plus the European Commission to a meeting in Istanbul on October 25th and 26th to look for a pragmatic way forward. Initially, Mr Bisignani proposed that states might unilaterally waive some clauses in their bilateral agreements, selecting which partners the waiver would apply to. Under this scheme, because the clauses would merely be waived, they could be reinstated at any time (with a reasonable period of notice) if the results were not as had been hoped.

That idea is still alive, but for now the 15 participants have asked IATA to draw up a "multilateral statement of policy" that would express their common thinking and approach to liberalisation and to present it at a second summit early in 2009. This statement is likely to include, among other things, an avowal that the eventual signatories should be indifferent to the "citizenship" of airlines when granting rights to fly to their countries. That may sound like a small step, but it has the potential to rewrite the rules of the game by putting pressure on foot-dragging countries to change their protectionist ways. One person in Istanbul compares the possible impact of such a document to the human-rights provisions of the Helsinki Final Act, which helped trigger some of the changes that eventually led to the fall of the Berlin Wall 14 years later.

Nobody is more aware than Mr Bisignani that the industry may not have even 14 months, let alone 14 years, to get its house in order. “Airlines, like all other businesses, are facing enormous challenges,” he says. “But unlike other companies, they are denied basic commercial freedoms that could help them manage their business in this difficult time.”

Companies and human rights

Test case

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From The Economist print edition

How far can America's legal system be applied to foreign human-rights cases?

UNDER a grey sky on October 27th, Larry Bowoto provided an improbable splash of colour in his Nigerian *agbada* gown before the federal courthouse in San Francisco. He is the lead plaintiff in a case against Chevron, an oil giant based in California, over something that happened in May 1998 on a platform operated by Chevron's Nigerian subsidiary, nine miles off the Niger Delta. A group of more than 100 people, including Mr Bowoto, took over the platform for three days to protest against what Chevron was doing in the delta. The protest ended when Nigerian troops arrived and shot at the protesters, killing two. Mr Bowoto was injured and is now suing for damages.

Bowoto v Chevron is likely to test how the American legal system can be applied to human rights in other countries. The civil suit is being brought under the 1789 Alien Tort Claims Act, one of America's oldest laws (it was signed by George Washington). The act allows foreigners to bring civil cases before American courts arising from violations of law or treaty anywhere in the world. It was invoked just twice before 1980, when it was used by a victim of state repression in Paraguay. Since then the act has been invoked in around 100 cases. In 1993 a case against Radovan Karadzic for crimes against humanity in Bosnia broadened its applicability to non-state actors. In 1996 a group of Burmese villagers brought a suit against Unocal, another oil company (subsequently bought by Chevron), over the use of forced labour by Burmese soldiers guarding the route of a gas pipeline. The case was settled in 2004.

Opponents of the use of the Alien Tort Claims Act to sue companies for alleged human-rights violations associated with their operations include the Bush administration and many companies. They fear it could unleash a flood of suits and interfere with foreign policy. Proponents argue that international law has evolved since 1789, and now encompasses well-defined human rights that fall squarely within the act's simple wording. In 2004 America's Supreme Court affirmed that the act applied to violations of modern international laws as well as older ones, but its ruling left doubts about corporate cases. "It's still a question of whether aiding and abetting is sufficient [to bring a case]," says William Dodge, a professor at the University of California's Hastings College of the Law.

Bowoto v Chevron will test just this point. The plaintiffs say the Nigerian troops were transported to the platform in helicopters provided by Chevron and its local partner. Chevron says the protesters were hostage-takers who initiated the violence on the platform and are now motivated by the possibility of winning damages. *Bowoto v Chevron* has been making its way through America's courts for nearly a decade and has been refined to a narrow Alien Tort Claims suit, making it an ideal test case. Marco Simons, a lawyer with EarthRights International, one of the groups representing the plaintiffs, notes that the case has survived around a dozen motions for dismissal.

Nearly all Alien Tort Claims suits against companies—including one last year against Yahoo!, an internet giant, over assistance it provided to the Chinese government in the arrest of a pro-democracy dissident—have been settled on confidential terms. Only two have gone to trial. "Extractive industries especially need to go where the resources are—they have to do business with regimes with notorious records," says Tyler Giannini, a specialist in human rights at Harvard Law School, who was one of the lawyers who argued the case against Unocal. "These cases are important because they are setting standards for what is acceptable and what isn't."

But those standards are now in flux. "Some day the Supreme Court will take this on," says Mr Dodge. And if *Bowoto v Chevron* does not make it that far, other cases are in the pipeline: in February a case against Royal Dutch Shell, another oil giant, will get under way in New York on behalf of Ken Saro Wiwa, a hanged Nobel laureate, and other Nigerian plaintiffs.

 **BUSINESS**

Digital books

A new chapter

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From The Economist print edition

Google strikes a deal with publishers to make more books available online

AP



Fire up those scanners

TECHNOLOGY forces old laws to contort themselves in new ways. The phonograph and radio threatened to wreck the idea of music copyright—then embodied in sheet music. But lawyers struck novel compromises between new media and old laws: collection societies were set up to pay composers and performers, and the market grew. On October 28th a similar breakthrough was announced for accessing books online.

Google has reached a settlement with groups representing authors and publishers, who had sued the world's biggest internet company in 2005 for copyright infringement. Google has been scanning millions of books into digital form and making the text available online in small "snippets", to answer users' search queries. The company said this constituted "fair use" of the copyrighted material, since only a small part of the work was accessible. The Association of American Publishers and the Authors Guild disagreed. The resulting legal fight was widely expected to end in a settlement, but it took a while to agree on the terms.

Under the deal, Google will pay $125m to compensate copyright holders and will set up a "Book Rights Registry" to pay authors and publishers for the digital use and sale of works—akin to the collection societies that send royalty cheques to musicians and songwriters. People will be able to buy digital books outright, or pay to access them by the page. A small part of each book will be free to consult. Google will take 37% of the revenue and 63% will go to copyright holders. Publishers and authors can opt out of the programme. Books no longer covered by copyright will be free.

The settlement, which must still be approved by the court, may encounter problems. Collection societies often fall foul of antitrust law and require special exemptions from legislators. And Google has in effect been granted a licence over almost all copyrighted works represented in the suit, giving it an overwhelming advantage in online-book indexing and retrieval, says Jennifer Urban, a copyright expert at the University of Southern California. That may increase competition concerns that are haunting the firm.

The agreement will apply only in America, but is likely to serve as a model for other countries. If successful, it will open up a new realm of knowledge online—and a new market.

Australian commodities firms

From gold to lead

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From The Economist print edition

Fortunes in the mining business come and go faster than ever

Bloomberg



WHO wants to be a gazillionaire? Dotcom tycoons in the 1990s rose and fell over a period of years. The recent commodities boom, by contrast, made people fabulously wealthy in a matter of months. But their fortunes have evaporated just as quickly. There is no better example than Andrew Forrest (pictured), who left mobs of Australian investors howling back in 2002 after a foray into nickel mining blew up, only to recover in spectacular form.

In 2003 he assembled a new company, Fortescue Metals Group, out of a tiny investment in iron-ore tenements in Australia's Pilbara region. These areas had already been rejected by the industry's giants as too costly to develop because of their complex geology and relatively low-grade ore. By early 2008, before Fortescue had even pulled ore out of the ground, the global commodities boom had made Mr Forrest Australia's richest man, worth over A$8 billion ($7.7 billion). By June, just after the first (small) shipment, he was worth A$13 billion and his company A$36 billion. Four months later, he is worth A$3 billion ($2 billion), Fortescue is worth A$8 billion, and whether there will be a rebound or a further collapse is anyone's guess.

The contract price for iron ore to Chinese steel mills, of which Fortescue is a beneficiary, is for well over $120 a tonne, almost twice its level last year, and triple that of five years ago. It is enough to make even the highest-cost producer rich. But the word "contract" is losing its meaning. Chinese spot prices, having traded above the contract price for five years, have crashed from $186 a tonne in July to $80 a tonne today and continue to slide (see chart). Buyers are breaking contracts, bankers are pulling financing and projects are, inevitably, being scaled back.

Oreful

Iron-ore prices, $ per tonne, delivered in China

Metal Bulletin China fines index

Australia contract fines C&F Asia

200, 170, 140, 110, 80, 50

2006, 07, 08

Sources: Citi Investment Research & Analysis; *Metal Bulletin*

On October 28th Fortescue reversed its long-standing public optimism and announced it would curtail expansion, a huge blow given the importance of scale in efficient mining of iron ore. There had already been delays caused by technical snags, but nobody cared when prices were rising. Now they care quite a bit. How much it will cost Fortescue to produce a tonne of ore is the source of much debate in Australia's mining community. The best Australian producers can get their products to a port for under $10 a tonne, and then pay another $25 a tonne to ship it overseas, which makes them profitable even at today's prices. Fortescue's cost of getting ore to the ports ranges from $20 to $60 a tonne, reckons Carlo Caiani of Caiani & Company, a consultancy based in Melbourne. So it is unclear whether it can operate at a profit or not.

If Fortescue's production costs exceed the spot price, it would hardly be the only Australian commodities firm in trouble. Citigroup estimates that the spot price is below the production costs for 15% of copper producers, 25% of aluminium producers, 50% of zinc producers, 30% of nickel producers and 10% of iron-ore producers. High-cost producers in India are at risk, and high-cost producers in China—which are legion, because ore quality is poor—are already quietly shutting down, says Clarke Wilkins, an analyst at Citigroup.

So far no big company has gone bust. Much mining development in Australia is funded with equity, not debt, and is consequently not as financially stressed as you might think. In Fortescue's favour, it raised

equity and debt in 2006, and more money last year. But not everyone is so fortunate. Over the past four years, 380 junior mining companies have gone public in Australia and the crunch means few will ever produce anything, says Mr Caiani.

One of the greatest difficulties faced by a start-up is that financing is often done in stages, subject to meeting benchmarks. This is a difficult time to be moving from one stage to another. Mirabela Nickel, a firm listed in Australia, is developing a big nickel project in Brazil and, bankers say, is having to seek funds in a market that has lost any appetite for risk. It is hardly alone. And if the depressed prices continue for more than a year or prices fall further, even companies that are thought be safely capitalised will begin to be stretched.

At the very least, the falls mean that the wave of new output forecast over the next few years is unlikely to materialise. It is even possible that supply could contract. That, at least, is the prevailing sentiment. But a contraction could, in turn, provide a medium-term opportunity for marginal producers when Chinese demand starts to pick up again—and, perhaps, some further unexpected reversals of fortune.

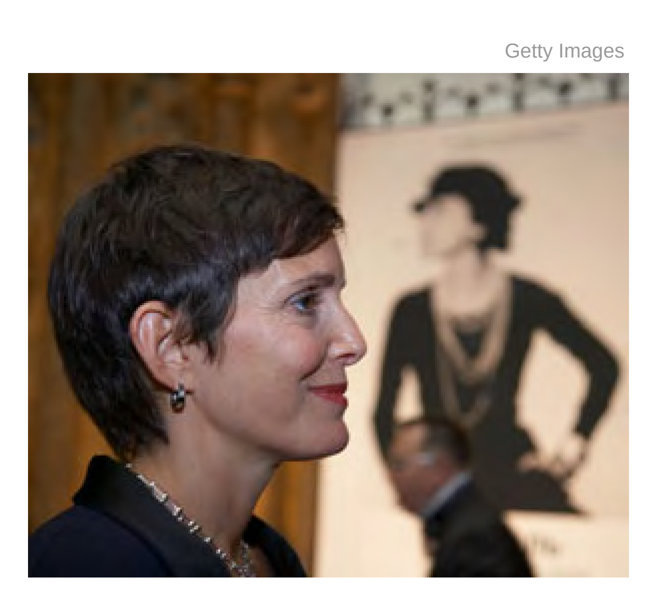
Face value

Coco futures

Oct 30th 2008
From The Economist print edition

Maureen Chiquet of Chanel hopes to keep a venerable brand relevant in trying times

Getty Images



THE luxury bubble which has buoyed her company for the past five years has burst, Maureen Chiquet acknowledges. But the boss of Chanel does not think the parties should stop. On October 21st the luxury-goods firm celebrated the arrival of its Mobile Art Pavilion in New York's Central Park. The peripatetic exhibit, which is open to the public until November 9th, contains works of art that pay tribute to Chanel's famous quilted-leather handbag (in ways that are not always obvious). Not everyone agreed that it was appropriate to celebrate one of the world's most expensive purses in the midst of a financial crisis. The *New York Times* scolded puritanically that although the exhibit "might have seemed indulgent a year ago, today it looks delusional". But Ms Chiquet rebuffs the criticism. "Even in tough times, people want to see beautiful and inspirational things," she says.

They may want to see them—but will they still buy them? Chanel's logo is a pair of entwined "Cs", the initials of the company's founder, Coco Chanel, but given the price of Chanel's wares the letters could just as easily stand for "credit crunch". The company, which has a diverse portfolio of handbags, perfume, cosmetics, clothing, jewellery and shoes, prides itself on being the ultimate purveyor of luxury, and sets its prices accordingly. Handbags start at around $1,500, and some sell for over $30,000. The firm's signature perfume, Chanel No. 5, is the world's bestselling fragrance, and costs around $100 a bottle.

The exclusivity of the brand is one of Chanel's biggest assets, Ms Chiquet insists. After becoming Chanel's global chief executive in January 2007, having previously been president of its American operations, she set herself two main tasks: to "upgrade" and to "modernise". In pursuit of the first, she worked to make Chanel's brand even more exclusive and appealing to "ultra-wealthy" consumers. She expanded Chanel's Luxe collection of elite offerings, which includes items like alligator bags, embroidered jackets, and top-of-the-line perfumes (named, rather appropriately, "Les Exclusifs"). At the same time, she set out to modernise the brand and make it more relevant to younger customers. She did this by renovating Chanel's boutiques and choosing Keira Knightley, a young British actress, as the face for the advertisements for Coco Mademoiselle, one of Chanel's perfumes. Ms Chiquet describes Chanel, when she came to it, as an apple: "beautiful underneath, but it needed to be dusted off a little bit". The new client base includes women, several Hollywood starlets among them, who became interested in Chanel only after Ms Chiquet started to polish the fruit.

Ms Chiquet has thus solidified Chanel's reputation as France's premiere house of haute couture. But her appointment raised eyebrows at the time because she is not French, had little experience in the luxury-

goods industry and had spent most of her career working for Gap, a mass-market clothes retailer. A native of St Louis, Ms Chiquet studied literature at Yale University and graduated with no mission other than to return to France, a country she had fallen in love with after travelling there while at high school. She got an internship at L'Oréal in Paris and travelled around the north of France selling hair products to supermarkets. She stayed at L'Oréal for over three years and dated a Frenchman in the marketing department. When he was about to be transferred, they decided to give up their jobs, get married and move to San Francisco, simply because the city "was beautiful".

Although she sounds like a romantic in the French mould, Ms Chiquet is also strategic. Once in San Francisco, she got a job at Gap as a merchandiser, selecting items of clothing and deciding how much to order. She caught the attention of Jenny Ming, who was starting Old Navy, a new division of Gap, and asked Ms Chiquet to join her even though it was unclear at the time whether the new venture would take off. Ms Chiquet accepted, enticed by Old Navy's mission—to sell fashionable clothes at very low prices—and helped build up the company to $5 billion in sales within five years. Ms Chiquet then left Old Navy to become president of Banana Republic, a mid-range clothes retailer in the Gap group, but was scooped up by Chanel soon afterwards. Her career trajectory provided perfect training for running Chanel, Ms Chiquet believes. At Gap she worked closely with the product; at Old Navy she built up a brand; and at Banana Republic she moved the firm from safari-gear into mid-range fashion. She has not, however, had experience leading a company during a potentially grave economic slowdown.

A woman in Coco's vein

Nobody is quite sure how the financial crisis will affect the luxury-goods industry, but there is generally agreement that it faces hard times ahead. A new report from Bain & Company, a consultancy, predicts that the luxury-goods market may shrink by 3-7% during 2009. As a privately held company, Chanel may have a bit more room for manoeuvre than its listed rivals, such as the market leader, Moët Hennessy Louis Vuitton. But Ms Chiquet says the company will have to "get smarter and more aggressive in some ways about how we're going to spend our money", meaning that Chanel may no longer be able to have five advertising campaigns running at a time.

Chanel's classic products continue to perform well, and sales of handbags and fine jewellery are strong, possibly because many customers consider these items "investments" that will not go out of style. Ms Chiquet does not plan to play it safe and stick only to the classics, however. The company was founded on defiance. Coco Chanel took women out of corsets and designed clothes inspired by menswear. Chanel's future prosperity, Ms Chiquet believes, still hinges on its pursuit of the avant-garde. So her insistence on pushing ahead with the extravagant art exhibit, which one staff member describes as "just a big commercial for Chanel", is a statement of intent in more ways than one.

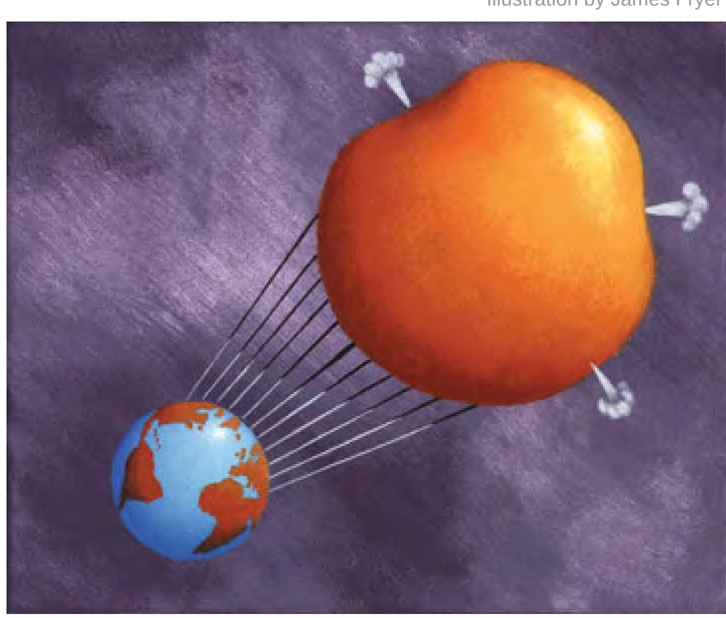
Policy in a recession

Putting the air back in

Oct 30th 2008
From The Economist print edition

Staring at recession, policymakers in rich economies are considering how to avoid a prolonged slump. Here are some options—and some obstacles

Illustration by James Fryer



DEBT is out; cash is in. Financial institutions are finding it hard to borrow from anyone but the state—and they are reluctant to lend to anyone else. Firms, aware that credit is drying up, are striving to raise cash. They have already run down their inventories and are trimming investment and jobs. Householders whose homes are worth less than their mortgages must save hard to reduce their debts. Those that cannot service their mortgages will default, causing more trouble for banks and, via lower house prices, other homeowners.

Just a few months ago, the main worry of policymakers in many economies was whether, as the prices of oil and other commodities shot up, they could contain inflation. But the flight from debt and the dash for cash, inelegantly called "deleveraging", means a bludgeoning for demand. Now central banks and governments are facing a new set of questions. First, can they stop deleveraging from gaining momentum and wrecking their economies? And second, will the tools of conventional macroeconomic policy—cutting interest rates, lowering taxes and increasing public spending—be enough?

The standard response to a demand shock is to use monetary policy: cut interest rates and increase the money supply. Lower interest rates spur spending by making saving less rewarding. Banks able to borrow more cash at lower cost from the central bank will usually offer more and cheaper loans to firms and households, to pay for new equipment, buildings and consumer goods, or to cover running costs.

Central banks are powerful because they control the "monetary base". This comprises the notes and coins in wallets, purses, petty-cash trays and tills, plus the cash reserves that commercial banks hold with the central bank. When interest rates are cut, the cost of holding money goes down; and more money in circulation means more spending. A boost to bank reserves has a less direct, but usually larger effect. Just as individuals carry cash to cover incidental spending, banks hold reserves to cover cash withdrawals, cheque payments and bank transfers. So bank reserves matter because they are the foundation for other, "broader" kinds of money—current (checking) accounts, interest-bearing deposits and so on. Because most deposits lie fallow on any one day, banks are safe in holding only a fraction of them in reserve. The ratio of broad to base money is known as the "money multiplier".

The banks are the conduit between central-bank policy and the wider economy. The trouble is, the conduit is blocked. Despite deep cuts in interest rates by the Federal Reserve, including one this week (see article), the cost of bank credit for American firms and households has not dropped by much. Investors are wary of lending to banks for even a few months, because of the risk that they may go bust or run out of cash. Banks are loth to lend to each other for the same reason (and fear of their own demise is leading them to hoard cash). The spread between what banks pay for overnight central-bank cash and what they pay to borrow for three months is therefore far above pre-crisis levels. The latter rate is the reference point for loans to customers.

Illustration by James Fryer

One route around this blockage is for central banks to lend directly to firms by purchasing their short-term debt at fixed rates, as the Fed started to do this week. A drawback, however, is that it essentially turns the central bank into a commercial bank, exposing the taxpayer to lending risk. And the fix helps only big firms.

The monetary base in big economies has been swollen by lots of liquidity from central banks. In the euro area, for instance, it has grown by one-third since the eve of the crisis in August 2007, even though interest rates are barely lower now than then. Most of the increase is accounted for by a doubling of bank reserves.

Some fear that such a rapid expansion of the monetary base will stoke inflation, which is still above 5% in America and Britain and 3.6% in the euro area. If the ratio of broad to base money were constant, such fears would be warranted. But because banks are using central-bank liquidity to plug holes in their short-term funding, the money multiplier is collapsing: even as reserves swell, broad-money and credit growth is wilting. In the year to September bank lending to British households rose by only 0.9%. Mortgage lending fell. If money is not circulating, but is stashed in reserves or under mattresses, it cannot boost spending or push up inflation.

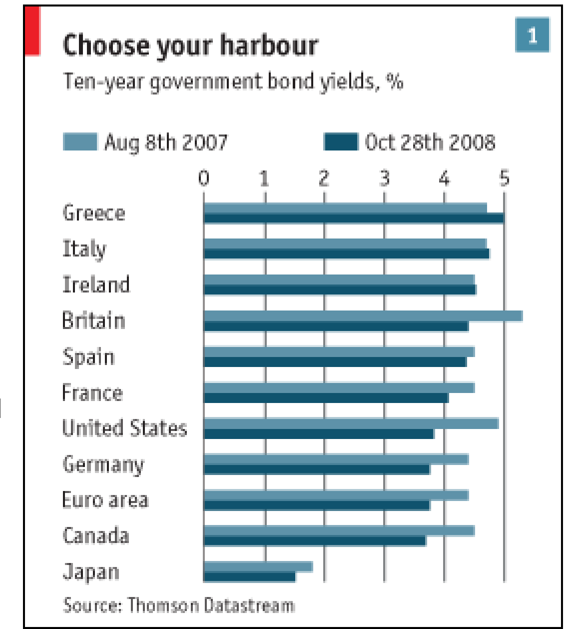
Indeed, if scared banks, firms and households cling more tightly to cash rather than lend it or spend it, the downturn will deepen. The more confidence weakens and asset prices fall, the more eager is the rush into cash. At the extreme, the demand for cash is so strong than not even interest rates at zero can get the economy moving. When standard monetary-policy responses reach their limit, fiscal options, such as cutting taxes and increasing public spending, come into play.

To some extent, government budgets in rich countries stabilise the economy automatically in booms and busts. When the economy slows and jobs are shed, the state spends more on unemployment benefits, helping to support aggregate demand. At the same time, tax receipts shrink faster than GDP: this hurts public finances in recessions but helps ease the pain for firms and their employees. The power of these automatic stabilisers is greater in Europe, where state benefits are more generous and the tax take higher, than in America.

The use of fiscal policy to fine-tune the business cycle in any more than this passive way went out of fashion around 30 years ago. Policymakers have since preferred to tweak aggregate demand via interest rates rather than taxes. One reason is that although it may be easy to increase public spending in bad times it is hard to reduce it when the economy revives. Tax cuts might be saved, or spent on imports. And continued budget deficits harm private enterprise by soaking up savings, pushing up interest rates and “crowding out” private investment.

But when skittish banks and investors are turning away from funding private spending, there is a strong case for a more active fiscal policy to prop up demand. The dash into safe assets has cut the cost of public borrowing for most rich countries (see chart 1). Low bond yields may be a market signal to “crowd in” public spending. A well-judged budgetary stimulus would help fill the shortfall in demand while debt-laden firms and consumers get their finances in order. It may prevent a recession from turning into a rout. A good package would minimise the drawbacks of fiscal policy: a roadbuilding programme, for example, would cease on completion; tax cuts could be aimed at the poor, who would be more likely to spend the extra cash than the rich.

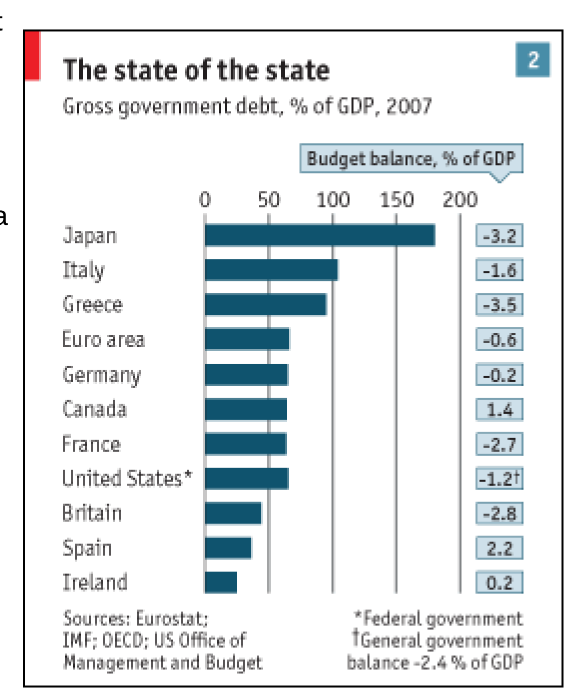
However, fiscal policy has its limits. A run of big budget deficits increases the risk that a government will default or repay its debts only by forcing its central banks to print money, creating inflation. If public debt spirals upwards as the economy stagnates, investors will worry that future taxpayers will be unable to shoulder the burden. Looser fiscal policy will stretch the public finances of countries that went into the downturn with big debts and budget deficits and have since had to fund bank bail-outs. Markets could choke on the extra bond sales required to finance huge deficits, driving interest rates up and worsening the downturn.



They are not choking yet. Financing government deficits is hard when investors are keen on rival uses for their money—such as companies' shares and bonds. In fact, investors are shying away from such assets. The omens for business investment from recent company reports and confidence surveys are poor. Job cuts, slumping asset prices and a worsening credit drought augur ill for consumer spending too. If firms fear that others will cut back their spending, it will make them still more cautious. The rot could easily feed on itself, leaving equipment and workers idle, and depressing tax revenues. A pre-emptive fiscal stimulus may help prevent that—and shore up the government's tax base.

If conventional monetary and fiscal policy fail, what then? Pessimists point to Japan's travails as a lesson in how a deflating asset-price bubble and a vast overhang of debt can defeat all that monetary and fiscal policy can throw at it. Since 1993 Japan's economy has been kept afloat by heavy government borrowing: the average annual budget deficit since then has been more than 5% of GDP. The economy flowered after 2003, thanks partly to a big intervention to weaken the exchange rate, but it is now close to recession again and threatened further by the rise of the yen. Japan's gross public debt has reached 180% of GDP, according to the OECD (see chart 2).

The sobering lesson is that conventional policy may not prevent a prolonged deflationary slump. This lesson has not been lost on policymakers. The nuclear option, conceived in America but untried in Japan, is to finance public spending or tax cuts by printing money. This requires the central bank to go along with the fiscal authorities (which may prove easier in America than in Europe). It could work like this: the government announces a tax rebate and issues bonds to finance it. But instead of selling them to private investors, it lodges them with the central bank in exchange for a deposit. It draws on this account to clear the cheques mailed to taxpayers. This scheme is essentially the same as the proverbial "helicopter drop" of money, but with neater accounting and a less erratic distribution of cash. It bypasses banks and money markets, and puts money directly into people's pockets.



Monetising a slug of public debt in this way is bound to be inflationary. But by this stage, inflation would be a blessing: an economy where conventional policy tools had failed would suffer from falling prices. A burst of inflation would lift asset prices, ease the weight on debtors (whose real burdens are increased by deflation) and improve public finances. Some central bankers will shudder at the thought. Some, but not all. Ben Bernanke, now the Fed chairman, recommended this course of action to Japan's policymakers in 2003 (when he was a Fed governor). Indeed, he went further. One way out of a slump, he argued, is for policymakers to commit themselves to a period of catch-up inflation, to break deflationary expectations and heal the wounds from past price falls.

If all else fails, it seems, the one sure way to secure solvency in the private and public sectors is to inflate away debts and buoy up asset prices. That nuclear option is the ultimate bail-out: rescuing the indebted by hurting those with savings. In essence, if not degree, it is not so different from conventional policy. Interest-rate cuts are a salve for debtors and a penalty on savers. Fiscal-stimulus schemes impose a cost on all taxpayers, even those well placed to endure a downturn. But the cost of a prolonged slump,

in terms of idle resources, lost income, decaying skills and an erosion in the trust that keeps civil society going, would be far higher.

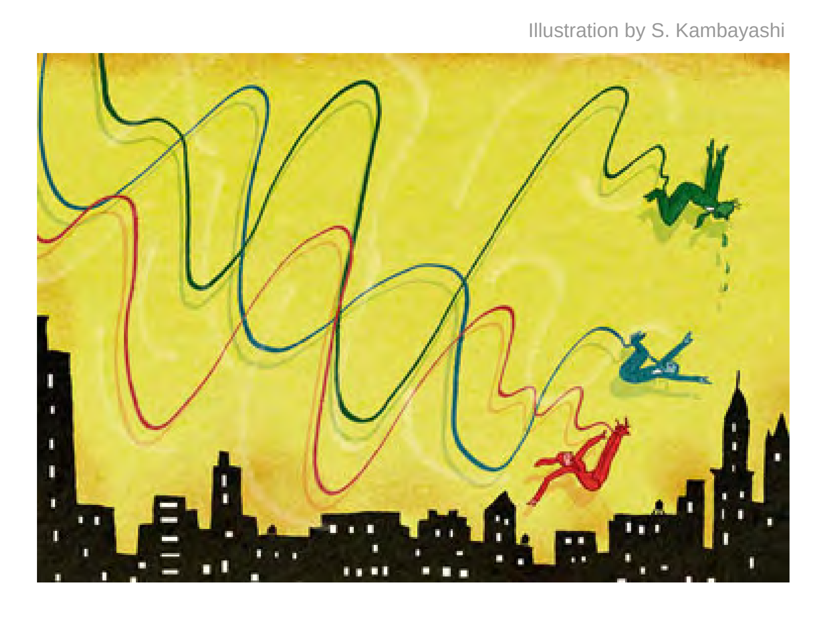
Market turmoil

Bad vibrations

Oct 30th 2008
From The Economist print edition

Violent moves in markets are forcing investors to sell assets

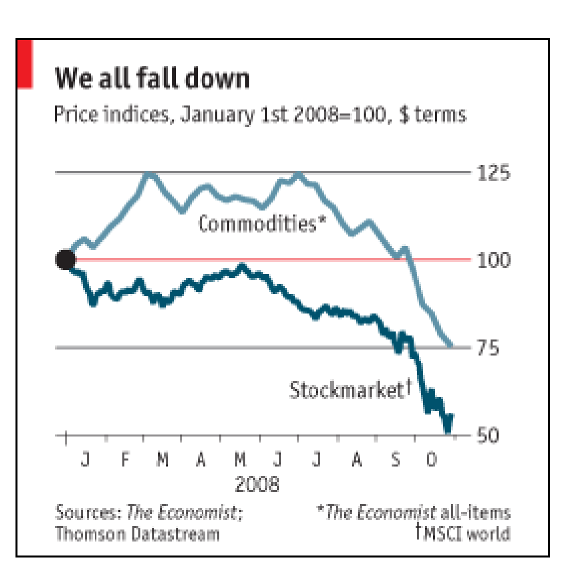
Illustration by S. Kambayashi



BUNGEE jumps may be exhilarating, but they can also be frightening. They end up with the participants much lower than when they started—and with their safety hanging by a thread.

That has been the experience of investors this year. There have been some phenomenal stockmarket rallies, like the one on October 28th that carried the Dow Jones Industrial Average almost 900 points higher. But there has been a much greater number of dismal dips.

Clearly, bad news about the global economy has played its part. Investors are worried that a widespread recession will prompt corporate bankruptcies (and thus bond defaults) and a sharp fall in profits (hitting equities). The prospect of an economic slowdown has also prompted them to call the end of the commodities bull market (see chart).



But the speed of market movements suggests another factor has been even more important. When investors are in trouble, they sell what they can, not what they would like to. It looks as if they have been dumping a whole range of assets.

Emerging stockmarkets, for example, have lost more than half their value this year, while emerging-government bonds were yielding more than eight percentage points above Treasury bonds, at least until a rally on October 28th. Leveraged loans (debts to finance management buy-outs) are trading at just 70 cents on the dollar.

Who is being forced to sell? One obvious answer is banks that have ended up owning far more risky assets than they would like. Barclays Capital put $970 million of leveraged loans up for sale in October; in the face of disappointing offers, it ended up selling just 30% of the lot. Other banks have been winding down their trading, a big source of revenue earlier this decade, in an attempt to reduce risk.

Another group of sellers is the hedge funds. After a disappointing performance this year, many are facing

calls for redemptions from clients and are having to sell assets to raise cash. But their problems also stem from their use of leverage, or borrowed money.

The great deleveraging, as it has become known, has also had a big impact on the currency markets. Many investors have been following a version of the “carry trade”, borrowing money in a low-yielding currency. All they had to do was earn a higher return from assets than the cost of their financing. Since the two big currencies with the lowest yields over the past year have been the dollar and the yen, those were the natural ones to borrow.

When asset prices fall, however, this strategy is disastrous. Investors dash to sell assets and repay their debts. Since those debts were incurred in dollars and yen, that means they have to buy back those two currencies—hence their sharp recent rises. (The yen has performed even better than the dollar because it had even lower rates, and thus was a more popular financing vehicle for carry trades.)

This process can be self-perpetuating. As the dollar and yen rise, those investors that have borrowed the two currencies face an increased cost of repaying their debts. So they sell assets to meet the bill, causing other speculative investors to cut their positions and so on.

The result of all these shifts looks like investment xenophobia. According to State Street Global Markets, American investors hold more than $5 trillion of foreign equities and are repatriating their money. Dismally though Wall Street has performed this year, it has still fallen less than emerging markets. Figures from AMG Data Services show that international mutual funds suffered $31 billion of redemptions in the third quarter, whereas American-based funds attracted $28 billion of inflows. As American investors bring their money home, that boosts the dollar.

So the pattern of recent financial markets has been pretty consistent. On bad days, equities, corporate bonds and commodities fall, while the yen and dollar rise. On the good days, the trends reverse.

What are the prospects for a few more good days? The most encouraging signs are in the money markets, which had threatened to bring the entire financial system to a halt. As of October 29th, three-month dollar Libor (the rate at which banks borrow from each other) had fallen for 13 straight days and was nearly one-and-a-half percentage points below its October 10th level. Thanks to a new Federal Reserve programme, companies are now able to borrow at longer maturities in the commercial-paper market. On October 27th and 28th, the amount of three-month paper shot up to $108.7 billion from $10.9 billion on the previous two trading days.

The Fed has also done its bit in terms of monetary policy, with its half-point cut on October 29th. Others are weighing in. China cut interest rates for the third time in six weeks on the same day. A quarter-point cut from the Bank of Japan was also expected. As the money markets thaw, those cuts should be passed on to borrowers.

Unfortunately, so many things have gone wrong this year that further shocks seem inevitable. Take emerging markets, where gathering economic woes are bound to lead to more bank losses, particularly in Europe. Alan Ruskin, an analyst at Royal Bank of Scotland, points out that European banks have more than seven times the claims on developing countries of their American rivals; in eastern Europe, the ratio is 25 to 1.

Then there is the continuing fallout in the structured-debt market. As more companies default, ripples will spread through a host of complex derivative products. Recent worries have been sparked by the failure of the Icelandic banks, which have caused some collateralised-debt obligations (CDOs) to plunge in value. The Bank of England, in its latest six-monthly financial-stability report, sharply raised its estimate for total global losses in the financial services industry to $2.8 trillion.

In these turbulent times, even good days for the markets can bring ruin, since some investors will be betting on the downward trend continuing. In the weeks to come, we will doubtless discover that the market’s latest bungee ride has made some funds violently sick.

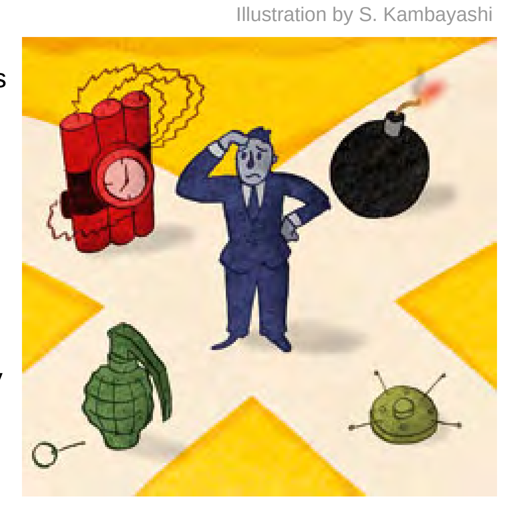
Buttonwood

All bets are off

Oct 30th 2008
From The Economist print edition

Spreading the risk has spread the losses

Illustration by S. Kambayashi



THERE is such a thing as a free lunch. That, at least, is what pension funds have been told in recent years. Diversify into new asset classes and your portfolio can improve the trade-off between risk and return because you will be making uncorrelated bets.

Boy, did pension funds diversify. They bought emerging-market equities, corporate bonds, commodities and property, while giving money to hedge funds and private-equity managers with their complex strategies and high fees.

The idea was to “be like Yale”, the university endowment fund run by David Swensen, a celebrated investor, which started to diversify into hedge funds and private equity in the 1980s. Compared with other institutional investors over the past 20 years, Yale had very little exposure to conventional equities. It also produced remarkably strong returns.

But those who thought Yale had found the key to success have been disappointed. Every one of those diversified bets has turned sour this year. In retrospect, it looks like the strategy had two problems. The first was that all risky assets were boosted by the same factors: low interest rates and healthy global growth. That encouraged investors to use leverage, or borrowed money, to enhance returns. The result was what Jeremy Grantham of GMO, a fund-management group, describes as “the first truly global bubble”. As confidence has unravelled, investors have been forced to sell all those asset classes simultaneously, driving down prices across the board.

The second, and related, problem is that some of the asset classes were quite small. Initially, this illiquidity was attractive since it seemed to offer more alluring returns. And as more investors became involved, their liquidity duly improved. But they still suffer from the “rowing boat” factor. When everyone tries to exit the asset class at once, the vessel capsizes.

Furthermore, some of these asset classes were always likely to be driven by the same factors as stockmarkets. Private-equity funds, for example, give investors exposure to the same kinds of risks as quoted companies, only with added leverage.

So was the whole idea of diversification a write-off from the start? The strategy’s defenders say no. They argue that pension funds (and other institutional investors) had made too big a bet on equities in the 1990s. When the bet went wrong with the bursting of the dotcom bubble, funds went into deficit.

They accept that, in a crisis, correlations head towards one; in other words, all asset classes (except government bonds) tend to fall together. But the diversifiers have three counter-arguments. The first is that any correlation less than one is still worth having. Hedge funds may have performed badly this year but their losses have been far lower than those of equity markets.

Second, there is a difference between short-term correlations and long-term ones. If you take a five- or ten-year view, it still looks as if property, commodities and the rest offer some diversification benefits. They did so during the equity bear market of 2000-02, for example.

Third, consultants like Colin Robertson of Hewitt Associates argue that diversification does work when it is applied in a sophisticated way. There is no point in diversifying if the investment does not offer a genuinely different source of return (much of private equity falls into this category) or if the asset is already overvalued.

Yet even allowing for this, diversification has surely not offered the benefits most pension funds expected. Indeed, it may have had perverse results. In the old days, with equities trading at below-average valuations, funds would now be on a buying spree. They could afford to ignore the short-term risks because of the long-term nature of their liabilities. Pension funds thus acted as an automatic stabiliser for the market.

This time round, that does not seem to be happening. One reason may be accounting changes which make pension-fund managers more focused on the short term. Another, however, may be the strategic drive to diversification. The *Wall Street Journal* has reported that CalPERS, America's largest public-pension fund, has been selling shares to meet commitments to put more money into private-equity firms.

The final problem with diversification has been the cost. Investing in quoted shares via an index fund is very cheap—a fraction of a percentage point. But diversified asset classes cost more to trade and involve higher management fees, expenses that eat into pension-fund returns.

So perhaps diversification has been a free lunch after all. Not for the pension funds, but for the fund managers.

Porsche and VW

Squeezy money

Oct 30th 2008
From The Economist print edition

How Porsche fleeced hedge funds and roiled the world's financial markets

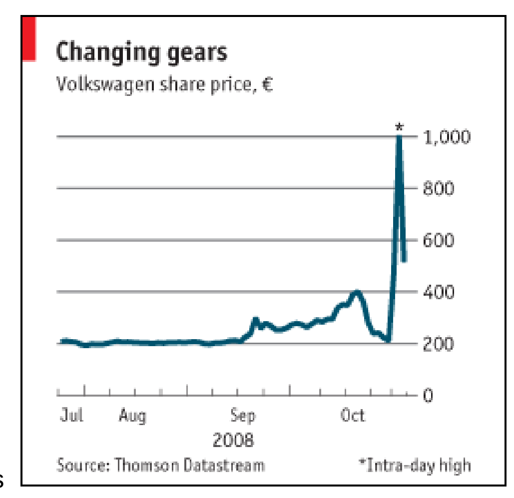
GREAT cornering and eye-popping acceleration make Porsche's cars popular among thrill-seeking bankers and hedge-fund managers. Now its clients are discovering that the carmaker itself has an unexpected talent for cornering markets. In a few tumultuous days it is thought to have made a cool €6 billion-12 billion ($7.5 billion-15 billion) on the share price of Volkswagen (VW)—a coup that has roiled the world's financial markets.

Porsche's gambit was as old as finance itself. For about three years it had been steadily increasing its stake in VW, a much larger yet less profitable carmaker with which it shares a little production. Its buying had driven up the price of VW's shares to above the level at which it would make any economic sense for Porsche to buy VW. Seeing this, hedge funds sold shares in VW that they did not own. One strategy was a bet that VW's share price would fall. Some also bought shares in Porsche, in a wager that shares of both would converge.

The risks of short selling should have been apparent to the brightest hedge-fund managers in Mayfair and Greenwich because of widespread suspicion that Porsche, a dab hand in currency-derivatives markets, was also mucking about with options on VW stock. Adam Jonas of Morgan Stanley warned clients on October 8th of the danger of playing "billionaire's poker" by betting against Porsche. Max Warburton of Alliance Bernstein said Porsche could make billions by squeezing short-sellers of VW's shares.

At the time Porsche dismissed these musings as a "fairy-tale". But on October 26th it executed a handbrake turn, saying that it owned nearly 43% of VW's shares outright and had derivative contracts on nearly 32% more. That meant it had tied up almost all of the freely available shares (the rest are held by the state government and index funds). Hedge funds quickly did the maths, concluding that they could be caught in an "infinite squeeze" in which they were forced to buy shares at any price.

Their frenzied buying sent VW's share price soaring (see chart). After languishing below €200 last year, it jumped to more than €1,005 at one point on October 28th, briefly making VW the world's most valuable company. Porsche may have made paper gains of €30 billion-40 billion in what one analyst described as "one of the most brilliantly conceived wealth transfers ever." Porsche says it never intended to make money on derivatives and only bought them to protect its planned purchases of VW stock. On October 29th it said that it would settle up to 5% of its VW options, freeing up a similar portion of stock and sending the price down again.



Hedge funds that take bad bets may garner little sympathy, but the VW saga does more than punish a few "locusts". On October 28th shares in Morgan Stanley, Goldman Sachs and Société Générale wobbled on worries (denied by all) that they might also be exposed to VW. If the losses are big enough to cause the failure of even a few hedge funds, that would spell more pain for the battered banking system. Other casualties include buyers of passive funds that track the German market who will end up with a disproportionate stake in VW within their portfolios. With VW's share price falling again, those who sell now will lock in a loss.

The greatest damage is to the reputation of Germany's capital markets, where regulators are now belatedly investigating what went on. Allowing acquirers to build large secret stakes in bid targets does nothing for confidence. Even Porsche may come to rue its coup. "They may struggle to sell 911s to hedge-fund managers for years and years to come," says one investor.

 FINANCE & ECONOMICS

Developed economies

Over the edge

Oct 30th 2008
From The Economist print edition

America and Europe appear to be heading for severe recessions

AS RECENTLY as a month ago, there were still hopes that America and Europe might just pull back from the precipice of a recession. Those hopes have been dashed. The economies of the rich world seem to have fallen off a cliff. The question now is the height of the drop.

AFP



The wheels come off

Central banks are trying to cushion the fall. On October 29th the Federal Reserve lowered its target for the federal funds rate to 1%, matching the trough it reached in 2003. It may cut again. With remarkable speed, worries have shifted from inflation, which is still around 5%, to deflation. Fed officials still think that, if even pessimistic forecasts came to pass, inflation would not fall below zero. But Macroeconomic Advisers, a forecaster, now reckons that core inflation will fall to 1.3% by 2010, too close to zero for the Fed's comfort. They expect the Fed to cut the federal funds rate to 0.5% in December and then, with scant room for more cuts, that it may try to stimulate growth using unconventional measures such as further expanding its lending facilities to banks and other firms.

The rate cut was needed. America's economic data have become starkly weaker since the bankruptcy of Lehman Brothers in mid-September. The latest GDP numbers, released on October 30th, showed that output fell by an annualised 0.3% in the third quarter. Surveys of manufacturing activity have shifted down. Weekly initial claims for unemployment benefits have shot up. A monthly index of consumer attitudes compiled by the Conference Board, a research group, plummeted to a record low of 38 in October, down from 61.4 in September.

Confidence surveys are unreliable predictors of consumer spending. But the destruction of wealth through falling stockmarkets and tightening credit conditions are already having an effect. On a seasonally adjusted basis, light-vehicle sales in September were the lowest since 1992, according to Autodata Corp, a research firm. On October 28th Whirlpool, an appliance maker, gave warning that low home sales would cut revenue and Royal Caribbean Cruises, a cruise operator, lowered profit estimates because of "a significant deterioration recently in new bookings".

A similar downward lurch is under way in Europe, where the European Central Bank seems poised to cut interest rates for the second time this autumn on November 6th. The Munich Ifo Institute's index, which measures the mood of German businesses, sank to its lowest level for more than five years in October. Volvo wins the prize for statistic of the crunch to date. The Swedish firm said it had received a mere 115 orders for heavy trucks in Europe in the third quarter, down by 99.7% on the 41,970 order bookings during the same period of 2007.

America and Europe cannot count on exports to make up for faltering domestic demand, because the crisis has spread to emerging markets. Airbus and Boeing, for example, had counted on orders of 300

aircraft from India in the next five years to help offset slower demand in Europe and America. Some of those are in jeopardy. Jet Airways, India's largest domestic carrier, announced its biggest quarterly loss in more than three years on October 25th.

Economists disagree about how bad it will get. Dean Maki of Barclays Capital says that falling wealth tends to affect consumer spending over many years rather than right away. It is just the opposite with changes in real income because of petrol prices. Consumer spending could conceivably be lifted by the sharp drop in oil prices that has unfolded since July, which Macroeconomic Advisers estimates to be worth more than $100 billion on an annualised basis. Mr Maki notes that consumer confidence plunged after the September 11th terrorist attacks but that Fed rate cuts enabled interest-free loans which dramatically boosted car sales. Another small positive sign is that home sales rose slightly in September and that house prices have actually risen in a few cities.

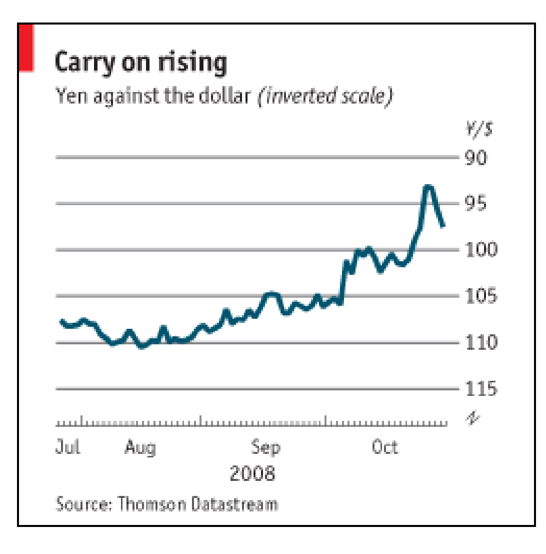
These glimmers may be snuffed out by the unprecedented tightening in credit now under way. According to Ed McKelvey of Goldman Sachs, the only comparable modern precedent is the federal government's short-lived imposition of credit controls in early 1980, which produced a dramatic downturn in American consumer spending. That episode ended when controls were removed. Today, credit restraint chiefly depends on how long it takes the private sector to respond to policy actions such as the Fed's commercial-paper purchases and the widespread recapitalisation of weakened banks. "Government is working as hard as it can, but in the end it's the private sector that does the lending," he says.

Japan's economy

That sinking feeling

Oct 30th 2008 | TOKYO
From The Economist print edition

The financial crisis finally catches up with Japan



Source: Thomson Datastream

WITH luck rather than skill, Japan escaped the bubbles in housing, credit and commodities. As Western banks suffered, Japanese ones even went on a small acquisition spree. But the (fairly) good times are over. The unwinding of the yen carry trade, in which investors borrowed low-interest yen to place in higher-yielding assets abroad, has helped to send the yen soaring (see chart). Exotic foreign-currency products sold to retail investors reinforce the currency's upward trajectory.

The stronger currency threatens the profits of Japan's big exporters, contributing to a stockmarket rout, which in turn is winnowing Japanese banks' capital. To alleviate the woe, the Bank of Japan was expected to cut interest rates from 0.50% to 0.25% on October 31st. But the economy will still get walloped.



The value of the Tokyo market has fallen by almost half this year. On October 27th the Nikkei-225 average plunged to its lowest level in 26 years. Foreign hedge-funds are blamed for the woe, dumping Japanese shares to raise capital for margin calls and to return money to twitchy investors. Japan's is a liquid market—the ATM of Asia. Over 60% of trading volume is attributed to foreigners. With few domestic buyers, share prices tumble faster, which fuels further selling.

The falling stockmarket particularly hurts the banks. Japan's three "megabanks" hold some ¥12 trillion ($123 billion) in other companies' shares (ostensibly in order to cement business relationships, but really to thwart hostile takeovers). They are now carrying around ¥1.2 trillion in paper losses, according to Standard & Poor's, a ratings agency, and their average core capital ratio has fallen from 7.4% to 6.8%. A minimum of 6% is recommended; just now, 8% looks wise.

On October 27th Mitsubishi UFJ Financial Group, Japan's biggest bank, which in September paid $9 billion for a 21% stake in Morgan Stanley, announced that it planned to raise around $10 billion in capital. Other banks are considering similar fund-raising exercises, as politicians fret that thin capital bases will compel banks to scale back lending.

To cushion the economy, the government unveiled on October 30th a ¥5 trillion stimulus package. Other proposals include establishing a fund to buy shares in banks. Since banks could worry about the stigma of asking for help, the government may make capital injections mandatory.

More controversially, the government plans to suspend mark-to-market accounting rules, which force banks to value their holdings at market prices. Many experts oppose the move. A lack of transparency and overvalued bank assets prolonged the misery the last time. Why repeat the error?

There is also gathering momentum behind the idea of creating a sovereign-wealth fund. The idea's backers hope for ¥25 trillion, half from cash sitting in government accounts, the remainder borrowed from banks, with the state guaranteeing the loans. Politicians hope the measures will change the psychology of the market. It certainly needs a boost.

Emerging markets

Unfunded mandate

Oct 30th 2008 | RIGA
From The Economist print edition

The IMF adopts a more flexible approach

TIME was when a bail-out by the International Monetary Fund was a uniformly horrid experience. Cold-eyed, sharp-suited men pored over your country's books, demanding painful structural reforms and bone-chilling fiscal stringency. Faced with the current turmoil in emerging markets, the fund now seems more like a generous uncle.

Well-run countries now have fewer hoops to jump through to gain IMF money. On October 29th the fund announced the creation of a new short-term liquidity facility for the soundest emerging markets. The facility will disburse three-month loans to countries with good policies and manageable debts without attaching any of its usual conditions. The Federal Reserve added its considerable firepower to the rescue effort, announcing the establishment of $30 billion swap lines with each of the central banks of Brazil, Mexico, South Korea and Singapore.

The fund's traditional lending also comes with fewer strings attached. The IMF-led $25.1 billion bail-out of Hungary on October 28th was "fast, light and big", in the words of one person involved. The rescue came just days after the fund agreed on a $16.5 billion package to shore up Ukraine's collapsing economy, a prospect which seems to be unblocking the country's wretchedly deadlocked politics. It is also standing by to help Pakistan.

The huge international support package for Hungary is a shocking turn of fortune for eastern Europe, a region that has enjoyed growth and stability for a decade. But a toxic combination of external debt and collapsing confidence left the economy floundering. Even spending cuts, tax increases, a €5 billion ($6.7 billion) loan from the European Central Bank and a sharp rise in interest rates, from 8.5% to 11.5%, had failed to calm the markets.

The fund had tried to get the governments of Germany, Italy and Austria on board for the rescue. Their banks are most exposed to Hungarian borrowers (thanks to eager lending in euros and Swiss francs). Austria was willing to take part; Germany was not. So the IMF has put up $15.7 billion (to be agreed on at an IMF board meeting shortly), the European Union has added $8.1 billion, and the World Bank a further $1.3 billion. In return, all Hungary has to do is pass a law on fiscal responsibility that is already before parliament.

The fund may be calculating that it is better to be lavish before a crisis than stringent after one. Iceland, which is negotiating a $2 billion bail-out from the IMF, is being forced to take some bitter medicine after the failure of its banks. The central bank raised interest rates by a full six percentage points to 18% on October 28th, as trading resumed in the Icelandic krona after a suspension of nearly a week.

The big uncertainty now is how many more fires the fund and other lenders must fight—and whether they can afford to do so. The IMF may well need more than the $250 billion it now has. Gordon Brown, Britain's prime minister, wants countries with big surpluses, such as China and the oil-rich Gulf states, to contribute more. The fund's backers, it seems, need to be as flexible as its new lending criteria.

Insurance

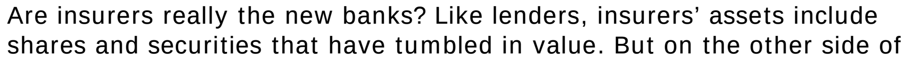
Under the covers

Oct 30th 2008
From The Economist print edition

The riddle of insurers' solvency

INSURERS are following a plot with an ending that may seem grimly inevitable. Their shares have sunk on worries that losses on their investments will leave them insolvent. Regulators and executives have tried to reassure investors, but been met with dark mutterings about insurers' reluctance to mark assets fully to market and their habit of inflating their capital with hybrid debt rather than plain equity. Some insurers' credit-default swaps, which measure the risk of bankruptcy, have soared to scary levels (see chart).

Pessimists argue that the final act—state bail-outs—has now begun. In the Netherlands both ING and Aegon have received capital injections from the government. America's life-insurance companies, a couple of which have already raised capital, are lobbying to be included in the Treasury's $250 billion programme to purchase stakes in financial firms.



Are insurers really the new banks? Like lenders, insurers' assets include shares and securities that have tumbled in value. But on the other side of the balance-sheet the comparison becomes laboured. Unlike banks, which rely heavily on debt funding, insurers' main liabilities are the claims they will pay their customers—for life firms these stretch over many years. Whereas the depositors and lenders who provide funds to banks can jump ship overnight, insurance customers find it hard and expensive to wriggle out of their contracts.

A run on an insurance company is thus hard to imagine. In theory that means capital adequacy can be reviewed at a dignified pace. But the industry has failed to create any measure of solvency that is accessible to outside investors. Insurance subsidiaries in individual countries and American states are regulated separately, often using different rules on, for example, mark-to-market accounting. European holding companies do have a single, numerically expressed, standard, called the insurance groups directive (IGD). Virtually all big companies still pass this, but most argue that it is too primitive to be useful.

So the question of solvency has largely been outsourced to the credit-rating agencies, with almost all companies targeting the equivalent of a AA rating from Standard and Poor's (S&P). This has its advantages. A snapshot of some firms' balance-sheets might not pass strict AA standards. But Mark Puccia of S&P says that, although some downward drift in global insurance credit scores is likely, the agency is not "marking to market". Insurers have time to rebuild their capital through earnings. Ratings also reflect subjective factors such as the quality of management. With the exception of American International Group, a just-nationalised American insurer, the agencies have not serially downgraded big companies in the midst of the crisis.

That the agencies are not putting guns to insurers' heads is confirmed by Michiel van Katwijk, Aegon's treasurer. He says the decision to solicit €3 billion of government funds was "precautionary". Based on valuations at September 30th, Aegon's new cash could leave it with twice the capital needed under Europe's IGD rules.

The stance of both executives and the rating agencies suggests that insurers will avoid an avalanche of emergency capital raising, although some will cancel dividends and tap governments if the terms are favourable. The problem for investors is the sheer opacity of insurance solvency models. In today's markets, "trust me" just doesn't cut it.

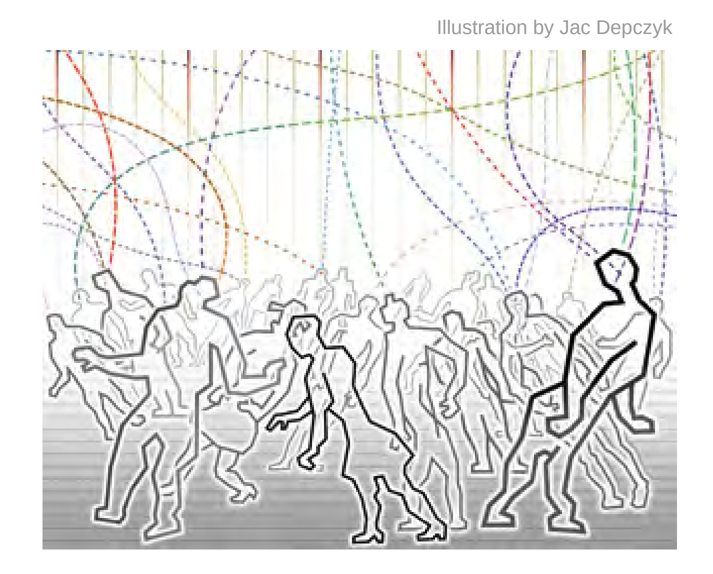
Economics focus

A biased market

Oct 30th 2008
From The Economist print edition

Skewed news reporting is taken as a sign of a dysfunctional media. In fact, it may be a sign of healthy competition

Illustration by Jac Depczyk



BARACK OBAMA recently told a writer for the *New York Times Magazine* that he was convinced he might be two or three percentage points better off in the polls for the American presidential election if Fox News, a right-leaning television station, did not exist. Sarah Palin, the Republican nominee for vice-president, has made hay railing against the bias of the "liberal media". Allegations of partial news reporting are common in American politics. But few stop to ask what leads to differences in the way the news is reported.

Bias can be thought of as a supply-side phenomenon that arises from ideology. Owners' or employees' political views will determine how a newspaper or channel slants its coverage of a piece of news. But this does not square with the assumption that readers and viewers value accuracy. If so, then competition should hurt media outlets that systematically distort the news (in any direction). The brouhaha about bias in America, as free a media market as any, suggests something else is going on.

The key to understanding why bias flourishes in a competitive market may lie in thinking more clearly about what readers actually want. Sendhil Mullainathan and Andrei Shleifer, two Harvard economists, argued in an influential paper* that it may be naive to think that people care about accuracy alone. Instead, they modelled the consequences of assuming that newspaper readers also like to have their beliefs confirmed by what they read. As long as readers have different beliefs, the Mullainathan-Shleifer model suggests that competition, far from driving biased reporting out of the market, would encourage newspapers to cater to the biases of different segments of the reading public. A more recent paper** by Matthew Gentzkow and Jesse Shapiro, two economists at the University of Chicago's business school, set out to test this proposition.

To do so, they first needed a way to measure the political slant of American news coverage. Their solution was rather imaginative. The researchers ran computer programs that analysed debates in Congress and identified phrases that were disproportionately used by Republicans or Democrats. The list of frequent Democratic phrases, for example, included "estate tax". While talking about the same issue, Republicans tended to use the phrase "death tax". (This is not just coincidence. Mr Gentzkow and Mr Shapiro quote an anonymous Republican staffer as saying that the party machine trained members to say "death tax", because "'estate tax' sounds like it hits only the wealthy but 'death tax' sounds like it hits everyone".) Having identified partisan phrases, the academics then analysed the news coverage of more than 400 American newspapers to see how often they cropped up in reporting. This gave them a precise measure of "slant", showing the extent to which the news coverage in these papers tended to use politically charged

phrases.

Mr Gentzkow and Mr Shapiro then needed to assess the political beliefs of different newspapers' readerships, which they did using data on the share of votes in each newspaper's market that went to President Bush in the 2004 presidential elections, and information on how likely people in different parts of that market were to contribute to entities allied to either Democrats or Republicans. The researchers were now able to look at the relationships between circulation, slant, and people's political views.

First, they measured whether a newspaper's circulation responded to the match between its slant and its readers' views. Not surprisingly, they found that more "Republican" newspapers had relatively higher circulations in more "Republican" zip codes. But their calculations of the degree to which circulation responded to political beliefs also allowed them to do something more interesting: to calculate what degree of slant would be most profitable for each newspaper in their sample to adopt, given the political make-up of the market it covered. They compared this profit-maximising slant to their measure of the actual slant of each newspaper's coverage.

They found a striking congruence between the two. Newspapers tended, on average, to locate themselves neither to the right nor to the left of the level of slant that Mr Gentzkow and Mr Shapiro reckon would maximise their profits. And for good commercial reasons: their model showed that even a minor deviation from this "ideal" level of slant would hurt profits through a sizeable loss of circulation.

Have I got skews for you

Showing that newspapers have a political slant that is economically rational does not necessarily answer the question of whether ownership or demand determines bias. Here, the academics are helped by the fact that large media companies may own several newspapers, often in markets that are politically very different. This allowed them to test whether the slants of newspapers with the same owner were more strongly correlated than those of two newspapers picked at random. They found that this was not so: owners exerted a negligible influence on slant. Readers' political views explained about a fifth of measured slant, while ownership explained virtually none.

None of this is particularly helpful to seekers of the unvarnished truth. These conscientious sorts still have to find the time to read lots of newspapers to get an unbiased picture of the world. But by serving demand from a variety of political niches, competition does allow for different points of view to be represented. After all, just as Mrs Palin does not spend her time condemning Fox News, Mr Obama is unlikely to have too many complaints about the *New York Times*.

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* "The Market for News", American Economic Review (September 2005).
** "What Drives Media Slant? Evidence from U.S. Daily Newspapers" (May 2007)
http://faculty.chicagogsb.edu/matthew.gentzkow/biasmeas081507.pdf

Correction: The IMF

Oct 30th 2008
From The Economist print edition

In an article on the IMF last week we published a list of countries that we said were in talks with the fund. Latvia says it is not in talks with the IMF. Bulgaria and Romania deny any intention to borrow from the fund. Our apologies. This article has been changed online.

Warfare

Fighting with photons

Oct 30th 2008
From The Economist print edition

Corbis



The most famous weapon of science fiction is rapidly becoming fact

LIKE so much else in science fiction, the ray gun was invented by H.G. Wells. In the tentacles of Wells's Martians it was a weapon as unanswerable by earthlings as the Maxim gun in the hands of British troops was unanswerable by Africans. Science fiction, though, it has remained. Neither hand-held pistols nor giant, orbiting anti-missile versions of the weapon have worked. But that is about to change. The first serious battlefield ray gun is now being deployed. And the next generation, now in the laboratory, is coming soon.

The deployed ray gun (or "directed-energy weapon", in the tedious jargon that military men seem compelled to use to describe technology) is known as Zeus. It is not designed to kill. Rather, its purpose is to allow you to remain at a safe distance when you detonate unexploded ordnance, such as the homemade roadside bombs that plague foreign troops in Iraq.

This task now calls for explosives. In practice, that often means using a rocket-propelled grenade, so as not to expose troops to snipers. But rockets are expensive, and sometimes miss their targets. Zeus is effective at a distance of 300 metres, and a laser beam, unlike a rocket, always goes exactly where you point it.

At the moment, there is only one Zeus in the field. It is sitting in the back of a Humvee in an undisclosed theatre of war. But if it proves successful it will, according to Scott McPheeters of the American army's Cruise Missile Defence Systems Project Office for Directed Energy Applications, be joined by a dozen more within a year.

You fight with light?

If Zeus works, it will make soldiers' lives noticeably safer. But what would really make a difference would be the ability to destroy incoming artillery rounds. The Laser Area Defence System, LADS, being developed by Raytheon, is intended to do just that—blowing incoming shells and small rockets apart with laser beams. The targets are tracked by radar and (if they are rockets) by infrared sensors. When they come within range, they are zapped.

If it works, LADS will be a disruptive technology in more senses than one. It will probably supersede Raytheon's Phalanx system, which uses mortars to do the same thing. Phalanx and its competitors require lots of ammunition, and can be overwhelmed by heavy barrages. By contrast, Mike Booen, vice-president of Advanced Missile Defence and Directed Energy Weapons at Raytheon, observes, as long as LADS is supplied with electricity it has "an infinite magazine".

And LADS is merely the most advanced of a group of anti-artillery lasers under development. Though Raytheon is convinced it is on to a winner and is paying for most of the development costs out of its own pocket, it has received some money from the Directed Energy Weapons Programme Office of the American navy. In August, inter-service rivalry reared its head, when the army handed Boeing a $36m contract to develop a similar weapon, known at the moment as the High Energy Laser Technology Demonstrator.

The army's Space and Missile Defence Command is also in the game. Its Joint High Power Solid State Laser, a prototype of which should be ready next summer, is meant to destroy rockets the size of the Katyushas used by insurgents in Afghanistan and Iraq, and by Hizbullah in Lebanon.

The most ambitious laser project of all, though, is the Airborne Laser, or ABL, being developed by the American Missile Defence Agency and Boeing, Lockheed Martin and Northrop Grumman. The beam is generated by mixing chemicals in a reactor known as a COIL (chemical oxygen iodine laser) and packs a far bigger punch than the electrically generated beams emitted by systems such as LADS. When mounted in the nose-cone of a specially converted Boeing 747, an ABL should be capable of disabling a missile from a distance of several hundred kilometres.

The aim is to hit large ballistic missiles, including ICBMs, just after they are launched—in the boost phase. The ABL is therefore a son of Ronald Reagan's Star Wars scheme, although in that programme, which dates back to the 1980s, the lasers would have operated from space.

There are many advantages to attacking a missile during its boost phase. First, it is still travelling slowly, so it is easier to hit. Second, it is easy to detect because of its exhaust plume (once the boost phase is over, the engine switches off and the missile follows Newton's law of gravity to its target). Third, if it has boosters that are designed to be jettisoned, it will be a larger target when it is launched. Fourth, any debris will fall on those who launched it, rather than those at whom it was aimed.

Getting the system to work in practice will be hard, though. A missile launch is observed using an infrared detector. Then the missile must be tracked. When the beam fires, the control system must compensate both for aircraft jitter and for distortions in the beam's path caused by atmospheric conditions. And ABL-carrying planes must be in the right place at the right time in the first place. Even so, a number of tests have been carried out, and according to Colonel Robert McMurry, the head of the Airborne Laser Programme Office at Kirtland Air Force Base in New Mexico, there will be a full-scale attempt to shoot down a boost-phase missile off the coast of California next summer.

All of which is good news, at least for countries able to deploy the new hardware. But wars are not won by defence alone. What people in the business are more coy about discussing is the offensive use of lasers. At least one such system is under development, though. The aeroplane-mounted Advanced Tactical Laser, or ATL, another chemical laser being put together by Boeing and the American air force, is designed to "neutralise" targets on the ground from a distance of several kilometres. Targeting data will be provided by telescopic cameras on the aircraft, by pictures from satellites and unmanned aerial drones, and by human target-spotters on the ground. The question is: what targets?

The ATL's supporters discuss such possibilities as disabling vehicles by destroying their wheels and disrupting enemy communications by severing telephone lines. Killing troops is rarely mentioned. However, John Pike, the director of GlobalSecurity.org, a military think-tank in Alexandria, Virginia, who is an expert on ATL, says its main goal is, indeed, to kill enemy combatants.

Surely this is forbidden?

Boeing is unwilling to discuss the matter and John Wachs, the head of the Space and Missile Defence Command's Directed Energy Division, observes that it is "politically sensitive". The public may have misgivings about a silent and invisible weapon that would boil the body's fluids before tearing it apart in a burst of vapour.

That seems oddly squeamish, though. War is not a pleasant business. It is doubtful that being burst by a

laser is worse than being hit by a burst from a machine gun. As the Sudanese found out at the Battle of Omdurman in 1898, the year that “The War of the Worlds” was published, that is pretty nasty too.

The placebo effect

Great expectations

Oct 30th 2008 | NEW YORK
From The Economist print edition

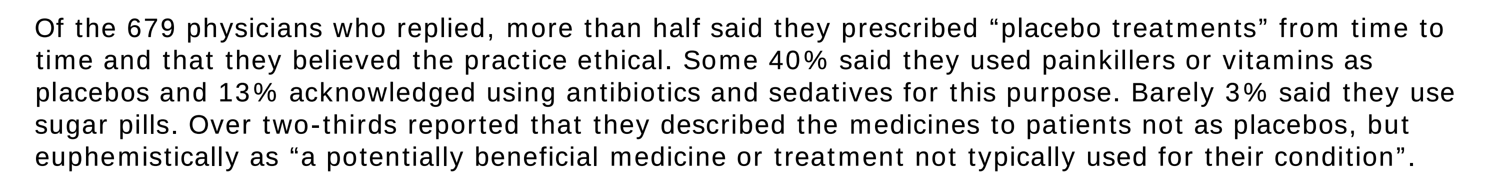
Should doctors give patients placebos?


Jupiter Images

IN 1572 Michel de Montaigne, a French philosopher, observed that “there are men on whom the mere sight of medicine is operative”. Over the centuries, all manner of sugar pills and bitter tonics have been given to patients in the belief that they might do some good and probably will do no harm. The snag is that doctors have usually prescribed them without telling patients that the pills contain nothing proven to cure their disease.

While some consider this a virtuous lie, others argue it is unethical. The American Medical Association (AMA) even issued this stern warning in 2006: “Physicians may use [a] placebo for diagnosis or treatment only if the patient is informed of and agrees to its use.” That ruling was influenced by an article published by two Danish scientists, Asbjorn Hrobjartsson and Peter Gotzsche, in the *New England Journal of Medicine*. This concluded that “outside the setting of clinical trials, there is no justification for the use of placebos”.

To find out whether doctors are observing the AMA’s controversial ruling, a team led by Jon Tilburt of the Mayo Clinic, in Minnesota, conducted a survey of American doctors. The results have just been published in the *British Medical Journal*. Dr Tilburt and his colleagues canvassed a randomly selected group of 1,200 general practitioners and rheumatologists, the two groups of doctors who most often deal with conditions such as chronic pain that respond well to placebos.


Of the 679 physicians who replied, more than half said they prescribed “placebo treatments” from time to time and that they believed the practice ethical. Some 40% said they used painkillers or vitamins as placebos and 13% acknowledged using antibiotics and sedatives for this purpose. Barely 3% said they use sugar pills. Over two-thirds reported that they described the medicines to patients not as placebos, but euphemistically as “a potentially beneficial medicine or treatment not typically used for their condition”.

There are two explanations for the apparent popularity of placebos. One is that trials have shown that they work, and that the way they work is starting to be understood. Fabrizio Benedetti of the University of Turin’s Medical School, author of a new book on this topic*, points to a wave of studies using imaging to show which parts of the brain are involved in placebo responses. His own research has even shown a placebo response at the level of single brain cells in patients suffering from Parkinson’s disease. He is convinced that scientists will soon be able to describe the “entire neuronal circuit which is affected by verbal placebo suggestions”.

Though the details remain murky, it is clear that the key to the placebo effect lies in the patient’s “positive expectation of a reward”, in the words of Nico Diederich, a neuroscientist at Centre Hospitalier de Luxembourg. He observes that the use of placebos leads to the secretion of a chemical called dopamine in the brains of people with Parkinson’s disease (an illness characterised by the loss of dopamine-producing cells). Placebos also lead to the release of the body’s own opioid painkillers in those suffering from pain.

Both Dr Diederich and Dr Benedetti point to a technique called hidden dosing that demonstrates the power of the placebo effect. In one study that used this, post-operative patients were given morphine secretly, given morphine with fanfare or given a placebo that was falsely declared to be a powerful pain reliever. This study, co-authored by Dr Benedetti and published in *Nature*, made the striking observation that telling a patient a painkiller is being injected into him, when the injection is actually a saline solution, is as potent as covertly giving him 6mg to 8mg of morphine. This is slightly below the standard post-operative dose of 10mg to 12mg, but the covert dose had to be increased to the full 12mg to surpass the effect of the placebo.

Great stuff, but there is a second reason why prescribing placebos may fall foul of the AMA: overworked doctors use them to deal with troublesome patients. In some cases this may still be legitimate. When a doctor suspects that a patient's suffering is due to behavioural or psychological factors, rather than physiological ones, he may use a placebo as a diagnostic tool. In other cases, though, the motives are less noble. A sympathetic doctor-patient relationship is believed to have a positive placebo effect in itself, but doctors do not get paid for holding your hand, notes Dr Tilburt. However, he observes, a placebo can sometimes be a good way of getting a whingeing patient out of the door quickly.

In the end, the controversy over the use of placebos is not likely to go away soon. Sceptics abound and ethicists frown, but doctors on the front-lines seem likely to continue to experiment with this potentially powerful tool while they wait for science to explain why it works. And perhaps they should, given the role that positive expectations and the doctor-patient relationship plays in healing. That may be why, Dr Diederich observes, "even the 'real stuff' also produces some placebo effect".

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* "Placebo Effects", Oxford University Press, October 2008



SCIENCE & TECHNOLOGY

Conservation

Managed to death

Oct 30th 2008
From The Economist print edition

If nothing is done soon, the bluefin tuna will disappear from the Mediterranean

IF EVER there were a graphic illustration of the tragedy of the commons, it is the plummeting of the world's stocks of bluefin tuna. Because they live in the high seas, these fish belong to everyone, and are thus no one's responsibility. The result is that the bluefin has been doomed to decades of poor management.

Matters, though, appear to be reaching a crisis. In a study to be published soon in *Conservation Letters*, a group of scientists led by Brian MacKenzie, of the Technical University of Denmark, describe how they ran a computer model of the species's population dynamics. Their conclusion is that even if fishing for bluefin were banned, the population in the north-east Atlantic and Mediterranean will probably collapse. The current management plan, to reduce quotas gradually over the next 15 years, will cause it to fall so far that bluefins in the area will qualify as critically endangered, the highest category of risk in the lexicon of conservation.

The organisation charged with changing that state of affairs is the International Commission for the Conservation of Atlantic Tunas (ICCAT), based in Madrid. However a measure of its success is suggested by its nickname, the "International Conspiracy to Catch All Tunas". Indeed, things are so bad that a recent review by a group of outside experts appointed by ICCAT itself concluded that the management of the bluefin was "widely regarded as an international disgrace".

Joseph Powers, a fisheries scientist at Louisiana State University who has been involved with ICCAT for a long time, says that, for the most part, the organisation's scientists agree with Dr MacKenzie. The evidence, he says, is clear. The quotas handed out by ICCAT have been around 30,000 tonnes a year. The science suggests they should have been 15,000 tonnes. The management plan calls for them to be reduced to 25,500 tonnes by 2010. Yet, in practice, around 50,000-60,000 tonnes of fish are landed because even legal catches are not properly monitored, and there is a thriving illegal fishery too.

The reason is that like any international organisation, ICCAT is little more than the sum of its member states. The office in Madrid is a secretariat that compiles statistics and organises scientific advice. It is not responsible for management. The real work is done at meetings of ICCAT's 46 members, where fisheries science collides with political horse-trading. At the next meeting, from 17th to 24th November, in Marrakech, the impending crisis will be the main item on the agenda. Fábio Hazin, chairman of ICCAT, says better management has been implemented but warns that scientific advice must be heeded.

Environmentalists have taken hope from a resolution passed at September's meeting of the International Union for the Conservation of Nature, the organisation which, among other things, hands out labels such as "critically endangered". Most countries, including Spain (an important tuna-fishing nation) and Japan (the main buyer of bluefin), voted in favour of a moratorium on catching the species, followed by improved management and control measures. However, what is said in the open at an environmental meeting may be different from what is done behind the closed doors of ICCAT's meeting. Britain, for example, voted in favour of the moratorium, but its delegation to Marrakech plans only to ask for "quotas based on science".

In a similar vein, one of ICCAT's most important participants, the European Union, said on October 28th that it would "champion bold and decisive measures". But all it is offering in practice is to attempt to "resolve the issue of overcapacity, reduce the length of the fishing seasons, and identify specific measures that can reinforce control throughout the market chain". A spokeswoman for the EU's fisheries directorate said the negotiations would respect scientific advice but would also take into account the positions of "stakeholders and NGOs", and added that a moratorium would mean "despair for Italian, Spanish and French fishermen". ICCAT, she added, "works very well".

Andy Rosenberg, a fisheries scientist at the University of New Hampshire who is one of Dr MacKenzie's

fellow authors, explains that member nations of ICCAT such as Italy, Spain and France allow their fishermen to go on fishing despite the fact that they belong to an international body that is supposed to have agreed on conservation measures. And Dr Powers says if ICCAT's members cannot both enforce the rules and accept that the quotas need to be small, then a complete moratorium "may be the best way forward".

ICCAT, which was created in 1969, is one of the oldest of what are known as the regional fisheries-management organisations. Then, bluefin tuna were so abundant that they were found throughout the North Sea and the Baltic, as well as in the Mediterranean. If this is an organisation that is working well, it is hard to imagine what failure would look like.

Economist.com BOOKS & ARTS

Franklin Delano Roosevelt

The man who saved his country, and the world

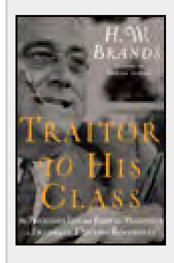
Oct 30th 2008
From The Economist print edition

Getty Images



If he is to succeed, America's next president needs to inherit at least a modicum of the character and talent that FDR brought to his tasks

Traitor to His Class: The Privileged Life and Radical Presidency of Franklin Delano Roosevelt
By H.W. Brands



Doubleday; 896 pages; $35

"MY POLICY is as radical...as the constitution," said FDR during the 1932 election campaign when he was accused of wanting to nationalise the utilities. In this impressive new biography, H.W. Brands, who has written books about Andrew Jackson and Benjamin Franklin, stresses the contrast between Roosevelt's aristocratic origins and his radical politics.

Roosevelt's ancestor, Philippe De La Noye, joined the Pilgrim Fathers on the *Fortune*, the next ship to arrive in Plymouth after the *Mayflower*. He was descended from Hudson Valley landed gentry and millionaire New York merchants, and went to Groton and Harvard. He grew up in the world of Edith Wharton. His fifth cousin, Theodore, was president of the United States, and he married Theodore's niece, Eleanor. (Mr Brands paints an understanding portrait of Eleanor and handles the couple's infidelities with tact.)

Though he had patrician self-confidence, there was no snobbery in Roosevelt. Mr Brands quotes FDR's friend, Ray Moley, as saying that there was nothing flabby about his charm: "When crossed he is hard, stubborn, resourceful, relentless."

Roosevelt was prepared to be radical to meet dangerous circumstances. Yet his instincts and the outcomes of many of his policies were often conservative. As a radical, he saved the old order—and advanced American power more than any other president since Jefferson.

In short, he was an extraordinarily complicated man, and the author copes skilfully with his complexity. Roosevelt became assistant secretary of the navy at 31 but eight years later was struck by polio. Mr Brands does not give too much credence to the theory that its onset was somehow connected with the shame Roosevelt felt about his bureaucratic responsibility for a scandal involving the homosexual entrapment of sailors.

He was in any event severely crippled, even for a time paralysed and incontinent. But by 1924, three years after he became ill, he had emerged again as one of the big beasts of the Democratic Party. His resurgence owed something to the success with which he concealed his disability, something to an age when journalism was less intrusive than it has since become. But more than anything else, it was due to his titanic determination. In 1928 he was elected governor of New York and in 1932, at the height of America's economic crisis, he was elected president.

Courage, charm, resourceful cunning and a hidden hardness enabled him to save American capitalism, though, as he said himself, it was Dr Win-the-War, not Dr New Deal, that ended the Depression. Mr Brands is masterly in describing the patience with which FDR brought the country to understand the danger of fascism. He is a bit less sure in his handling of international politics, adopting the traditional view that, in the strategic arguments over the second front, the American generals were right and Winston Churchill deluded by imperial nostalgia. He dismisses John Maynard Keynes as an "English intellectual", in whom it was impertinence to offer advice to an American president, apparently unaware that Keynes was a player at the Paris peace conference.

Roosevelt was determined to destroy imperialism. Mr Brands gives perhaps too much weight to a late night conversation recorded by his son Elliott, in which FDR claimed that Churchill and De Gaulle were conspiring to preserve the British and French empires. There may have been some warrant for Roosevelt's suspicions, but he was more aware than his son of the ambiguities of the Grand Alliance.

He possessed the subtlest political mind of his generation. At the same time he was a master of point-to-point navigation, moving not by plan but by instinct, tempered by experience.

Roosevelt was the greatest American president since Lincoln, his colossal abilities tested by personal illness, economic catastrophe and world war. He used every tool to hand to direct the United States in peace and war: party, bureaucracy, Congress and the media of the day. Whoever wins the presidential election of 2008 will find those levers rusted, weakened or twisted. His task will be to reconnect the presidency to the country and to the world—something that will take the talent and character Franklin Roosevelt brought to lead America from the nadir of economic distress to the zenith of power.

Traitor to His Class: The Privileged Life and Radical Presidency of Franklin Delano Roosevelt.
By H.W. Brands.
Doubleday; 896 pages; $35

Economist.com BOOKS & ARTS

Obsession

The double face of single-mindedness

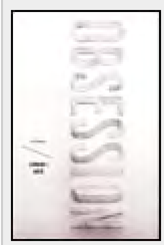
Oct 30th 2008
From The Economist print edition

A FINE day in 1879, a trip to the races—and for Francis Galton an opportunity to observe his fellow man. "When the horses approached the winning post, the prevalent tint of the faces in the great stand changed notably, and became distinctly more pink under the flush of entertainment," the great statistician wrote afterwards in *Nature*. At meetings of the Royal Geographical Society he estimated boredom levels by counting fidgets; in Africa he used a sextant and tape-measure to calculate the proportions of the buttocks of a "Hottentot" woman from afar. As he travelled about in Britain he created a "beauty-map", using a needle to prick holes in different parts of a piece of paper concealed in his pocket, recording whether the women he passed were "attractive, indifferent or repellent" (London's were loveliest).

Illustration by Daniel Pudles



Obsession: A History
By Lennard J. Davis



University of Chicago Press; 290 pages; $27.50 and £14.50

Praiseworthy activities or eccentric ones? Science or madness? A bit of both, says Lennard Davis in this history of obsession. But there is more to it than that. As the scientific world view rose to dominance, and life became more specialised, standardised and mechanised, behaviour that a century earlier, if it had occurred at all, would have been regarded simply as odd, became both more common and more commented on.

For centuries, madness had meant "idiocy" or "lunacy", both of which overthrew the mind entirely and left the sufferer fit only for permanent incarceration. But as Locke and Kant redefined the mind as an amalgamation of states and faculties, and reformers unchained the inmates of insane asylums, there came an increasing acceptance of madness as a partial or temporary state. Inevitably, more people came to be seen as mad, or to see themselves as so. Obsession in particular, with its characteristic two-mindedness—a compulsive self acts while an observing self watches helplessly—proliferated as a result of this "democratisation of madness".

Mr Davis devotes a chapter to "graphomania", the madness of incessant writing. The great 19th-century novelists were, he says, engaged in a project without precedent: "the continuous, cumulative production of words". Balzac's "La Comédie Humaine"and Zola's 20-novel cycle known as "Les Rougon-Macquart" aimed to create virtual worlds. Zola had inscribed on his mantelpiece the phrase "*nulla dies sine linea*" (no day without a sentence). These writers knew they were sacrificing their lives to obsession, but they accepted the price and others lionised them for it.

And so to the present, when obsession is both a common mental illness and a cultural ideal. The two are connected, thinks Mr Davis: twin results of a single process, and perhaps the inevitable consequence of modernity. In just a few decades "obsessive-compulsive disorder" has gone from extremely rare—affecting one person in 2,000 according to a 1973 estimate—to extremely common, affecting two or three people in 100.

And nowhere is the ideal more powerful than in love, where only the "can't eat, can't sleep" kind is seen as worth having. He describes, entertainingly, the way this spawns, in turn, yet further obsession, as couples peruse sex manuals that categorise and prescribe precise methods for love-making in a vain attempt to stop their ardour fading. An obsession with obsessive love leads to obsessive efforts to revive it: obsession to the power of three.

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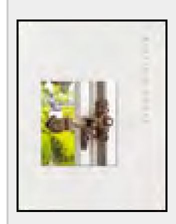
The nicest house in London

Ambassadorial pile

Oct 30th 2008
From The Economist print edition

FOR those rich McCain and Obama supporters coveting ambassadorships next year, Winfield House is definitely the place to be. Barbara Hutton, the heir to the Woolworth fortune and one of the richest women in the world, returned to London in 1945 to find the red brick mansion she had built for herself in decay (it had been used by the air force). She bequeathed the neo-Georgian pile for use as the residence of American ambassadors to the Court of St James's.

Winfield House
By Maria Tuttle and Marcus Binney



Thames & Hudson; 171 pages; £32

Buy it at
Amazon.co.uk

It was a generous gift. The house, set in 12 acres of garden in Regent's Park, has served as an elegant soft-power asset for America in Britain since 1955. The thousands of guests invited every year to dinner parties, cocktails, business lunches, even serious diplomatic negotiations, find themselves in a handsome setting that is grand yet warm.

The character of Winfield House—named after Hutton's grandfather, Frank Winfield Woolworth—fluctuates with the occupants. The current ambassador, Robert Tuttle, and his wife, Maria, a well-to-do couple from Los Angeles with a taste for contemporary American art, have taken a special interest in the house. They have kept it in sparkling condition, and primped some slightly down-at-heel rooms with subtle redecoration. In this book Mrs Tuttle and Marcus Binney, an architectural historian, focus on the splendour of the rooms—including the Art Deco marble master-bathroom—and the sweep of the surrounding gardens, supported by four greenhouses.

The crowning glory is the main reception room, called the Green Room, which is hung with hand-painted 18th-century Chinese wallpaper of jade background decorated with pink peonies, assorted birds and butterflies. The decor—Chinoiserie, pastel furniture, waxed-pine pelmet boards and parquet floor—reflects the taste of William Haines, a fashionable interior designer of the 1960s and 1970s who was hired by the Nixon appointee, Walter H. Annenberg.

An endowment from the Annenbergs paid for Haines to refurbish the entire house, and supports day-to-day maintenance even now. Smart ambassadors like Mr Tuttle and his wife treat Winfield House as a glamorous selling point that outstrips the ups and downs of the Anglo-American relationship.

The couple have injected a bold American theme by hanging pictures from their own collection. A Willem de Kooning hangs over the ornate mantel in the Green Room. An Ellsworth Kelly and Franz Kline from the Department of State's collection are in the classic surrounds of the staircase. Two Rothkos provide vibrant contrast to the perennial portraits of George Washington and Thomas Jefferson in the reception hall. If you are not one of the fortunate guests, these pages are the next best thing.

Winfield House.
By Maria Tuttle and Marcus Binney.
Thames & Hudson; 171 pages; £32

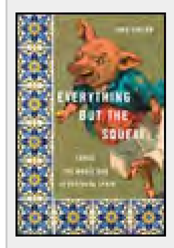
The joy of pork

The whole hog

Oct 30th 2008
From The Economist print edition

JOHN BARLOW, a British expatriate in Galicia, the rain-swept region of the Spanish north-west that gave birth to Franco, has an odd ambition: to eat every bit of a pig, from its tail to its snout. The ambition persists despite marriage to the long-suffering Susana, perhaps the only Galician vegetarian, despite the menace of cholesterol from all those fat-laden pork sausages and despite the threat (kindly pointed out by Susana) that eating pig brain will lead to Creutzfeldt-Jakob disease.

Everything But the Squeal: Eating the Whole Hog in Northern Spain
By John Barlow



Farrar, Straus and Giroux; 320 pages; $25. To be published in Britain by Summersdale in May

Buy it at
Amazon.com
Amazon.co.uk

What follows is a quixotic quest for the recipes that give good countryfolk—and doubtless Mr Barlow—ample waistlines and cheerful characters. The *cocido* (pork stew) from the politically conservative town of Lalín is nothing short of heroic in its mix of ingredients; there are kind words for Doña Aurora's trotter stew; and an enthusiasm for blood sausages whatever the gruesome process of making them.

All this may be great fun for foodies, but the attraction of Mr Barlow's book is that he goes well beyond the business of eating. He gives us a fascinating journal of his Galician wanderings, from village carnivals in the pouring rain to a hippy commune in the back of beyond via the pilgrimage to Santiago de Compostela. What comes through is a deep affection not just for Galicia's pigs—Mr Barlow singles out the long-backed Galician Celtic, hips swaying like Jayne Mansfield's, for special mention—but also for Galicia's people and culture.

No answer is ever a straightforward yes or no. No bureaucratic process is ever simple. No bit of history is without its compelling trivia (how many others would know, for example, that in Santiago de Compostela's 12th-century church of Santa María Salomé there is a statue of an angel wearing glasses?). Mr Barlow pokes his nose in everywhere, and almost without exception people are kind and hospitable.

He meets all sorts, from Fidel Castro's favourite cousin to Mañuel Fraga, minister under Franco, co-author of Spain's democratic constitution and still Galicia's political godfather. The charm is that Mr Barlow is so self-deprecating: his interview with Don Mañuel is a classic encounter between clueless journalist and superior, but patient, politician; his account of teaching phonetics at La Coruña's university will make many a teacher blush with self-recognition; his Yorkshireman's contempt for the posh British expatriate with barely a word of Spanish will amuse anyone with a knowledge of Britain's class system.

None of this yet puts Mr Barlow in the Eric Newby category of travel writer, but he comes close enough in this, his third book. As for Susana and baby Nico, they are sometimes there, and sometimes not. But Susana, it seems, never complains, even though Mr Barlow's ambition is clearly to indoctrinate Nico into the pleasures of pork.

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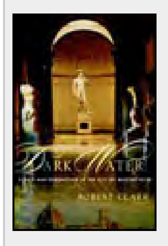
Flooded Florence

Angels of mud

Oct 30th 2008
From The Economist print edition

THERE are, writes Robert Clark, two concepts of the legendary city on the banks of the Arno in northern Italy. One, called Firenze, is populated by the proud, hard-working people who live there. The other, known to many as Florence, is home to the world's greatest concentration of sublime works of art. Both are susceptible to terrible flooding—and November is the cruellest month. The river Arno's first great flood happened on November 4th 1333; there were 3,000 deaths and the reason given was the sinfulness of man. On November 4th 1966 another great flood inundated the city; 33 people died and the blame fell principally on Enel, Italy's largest power company.

Dark Water: Flood and Redemption in the City of Masterpieces
By Robert Clark



Doubleday; 354 pages; $26

Buy it at
Amazon.com
Amazon.co.uk

Mr Clark's story of the 1966 flood embraces the tragic experiences of the inhabitants of Firenze, such as the father who watched helpless as the torrent snatched his six-year-old daughter from his grasp; and of the crippled old woman who was drowned in her wheelchair as the level of water rose to the ceiling. The rest of the world's greatest concern was for Florence, and the dire catalogue of damaged works of art: 321 panel paintings, 413 on canvas, 11 fresco cycles, 39 single frescoes and 158 sculptures, plus the devastation of 15 museums and 18 churches.

This dreadful list persuaded volunteers, mostly young and from Europe and America, to descend on Florence to help in buildings such as the Biblioteca Nationale, which contained up to 4m books, many in 22 feet (6.7 metres) of slime. These volunteers became known as *angeli del fango* or angels of mud. There were about 1,000 of them, and the author describes their commitment as "a proto-Woodstock of high visual culture".

Mr Clark, a novelist, tells an enthralling true story in a way that makes it read like a novel. His style can be mannered, but there are scenes in which the drama is moving. For example, Luciano Camerino, who survived Auschwitz, left his home in Rome to work in the synagogue on the Via Farina, unrolling and draping 120 priceless scrolls of the law over chairs and down aisles. After 72 hours of unceasing toil, largely on his own and without much food or rest, the old Jew raised his palm to his head and fell dead of a heart attack.

The symbol of Florence's artistic patrimony was a crucifix by Cimabue, an influential painter in the 13th century. It lay in the refectory at the church of Santa Croce, in the lowest-lying part of the city, covered by filthy, polluted water. Its condition received rather more attention than the hungry and the homeless of Santa Croce. Six days after the flood, Florence's mayor was moved to remark sharply: "Enough about Cimabue's poor Christ. Now we must think of the poor Christians."

One lesson from the floods is that works of art—buildings, paintings, statues and books—can usually be rescued and restored; human beings cannot be made whole again. But restoration is a controversial business, and Florentine and Roman factions still argue about the technique used to revive Cimabue's crucifix. Some pieces, however, come out of their ordeal in better shape than before. The restoration of Donatello's magnificent wooden Maddalena was so meticulously achieved that colours distorted by chemical concoctions used by earlier restorers were rediscovered. "She was still penitent, but also redeemed," says Mr Clark.

Dark Water: Flood and Redemption in the City of Masterpieces.
By Robert Clark.
Doubleday; 354 pages; $26

Renaissance tapestries

In praise of powerful women

Oct 30th 2008 | FLORENCE
From The Economist print edition

A tapestry exhibition in Florence glorifying two Medici queens

Mobilier National



To the glory of strong mothers of frail sons

THERE was no separation between fine and decorative art in the Renaissance; nothing artsy-craftsy about weaving. Tapestries made in the 15th, 16th and early 17th centuries were lush, intricately woven, illustrative panels created by teams of highly skilled workers using threads of many colours, highlighted with silks wrapped in silver or gold. The results were "portable frescoes" (art works that could be easily carted from one palace to the next). Being labour intensive—a series might take four or five years to complete—they were far more expensive than paintings and for that reason alone were more valued.

There were other reasons too. These tapestries were beautiful, kept out draughts and showed off a king's wealth. Most of all, a series that depicted the legend of a great hero from history or mythology offered flattering comparisons with the ruler who had commissioned it. This was art as propaganda; both advertising and enhancing power.

It was with this in mind that the story of two ancient queens both named Artemisia was conflated by a poet, Nicolas Houel, and illustrated by an artist, Antoine Caron. Their Artemisia was a great warrior but also a tender mother, devoted to her husband. They thought that the Florentine Caterina de' Medici, the reigning queen of France, would be happy to turn their efforts into tapestries. And indeed the 15 panels that make up the Artemisia cycle (along with supporting paintings and *objets d'art*) are the focus of "Women in Power: Caterina and Maria de' Medici", an exhibition running until February 8th at the Palazzo Strozzi in Florence.

However the visitor quickly learns that Caterina never commissioned the cycle. That took place some years after her death when France's Henry IV ordered them for his wife, Maria de' Medici, Caterina's distant cousin who was to become the last Florentine queen of France. The set was broken up in the 18th century, with half the panels going to England. They were reunited in France in 1999. This is the first exhibition devoted to the entire cycle and the tale it tells.

Caterina married the future Henry II in 1533, when both were 14. She was widowed at 40, when the king was fatally injured in a joust. She quickly took over as regent and remained in power (two of her sons dying young) until her third son, Henry III, eventually pushed her aside shortly before her death in 1589. Henry IV revived the tapestry scheme in 1601 when his wife, Maria, gave birth to a long-wanted son and heir, the future Louis XIII. But by then the tapestries had acquired a different purpose: instead of praising the virtues of a regent queen, they were to portray the education of an ideal prince, little Louis.

Eight of Caron's original drawings were thought suitable for their new purpose. Among them is a

charming depiction of a royal youth learning to ride while his mother looks on; also the sumptuous rewarding of warriors shown below. Seven new drawings, more static and military in nature, were done by Henri Lerambert. But soon after the cycle was completed, Henry IV was assassinated and Maria became regent for Louis, aged 9. In a twist worthy of O. Henry, that American master of surprise endings, the original intention of the Artemisia tapestries was fulfilled after all.

James Bradburne, the Palazzo Strozzi's director, is dedicated to making exhibitions accessible to a wide range of visitors. Although sometimes populism sails close to the wind of dumbing down (a comic book showing a futuristic Artemisia, for example), the results can be imaginative. Two successful Florentine craftsmen/businessmen, Wanny Antonio Di Filippo and Lorenzo Villoresi, have donated ten exceptional tapestry-covered carpet bags, each with a leather pomander exuding a fragrance that could have been made in the Renaissance. Not for sale, these bags are lent to families who want to play at dressing-up (the bags also contain a crown, a silk caplet and a sword).

"Women in Power" is a catchy but misleading title. This show is less about women in power than about women seizing power. As consorts, Caterina and Maria were powerless. It was the sudden deaths of their husbands that unleashed their tremendous, long-latent ambition and with it the canniness to succeed. Mistresses were banished; rival claimants to the regency, neutralised.

The Artemisia tapestries, especially those based on Caron's drawings, are dazzling. But they were not commissioned by either of the women whose stories they glorify. In Paris the Louvre offers an example of a great work that was. A large room is hung with the magnificent cycle of 24 paintings honouring the life of Maria de' Medici, which she commissioned from Peter Paul Rubens. Maria is said to have had few gifts for ruling but she certainly had a genius for inheritance planning.


PEOPLE
OBITUARY

Frank “Lefty” Rosenthal

Oct 30th 2008
From The Economist print edition

Getty Images



Frank “Lefty” Rosenthal, gambler and gangster, died on October 13th, aged 79

GAMBLERS usually go on until they have run out of both luck and money. Frank “Lefty” Rosenthal went on until he was blown up. But then Lefty was not your usual sort of gambler.

First, he was more of an oddsmaker and casino manager than a plain punter, and anyway he could never bring himself to give up gambling completely. Second, if the habit had to be brought to heel, it was not because of a lack of cash. Lefty spent the last decades of his life in considerable comfort, lacking for nothing except any reciprocation of affection from the “Latina lovelies” of South Miami Beach he so liked to ogle. Third, the bomb placed under his car in Las Vegas on October 4th 1982 did not mark the end of his luck. Quite the opposite. The blast would have killed him had a metal plate not been fortuitously fitted under the front seat of his Cadillac Eldorado to improve that model’s roadholding. It probably helped, too, that he turned on the ignition before closing the door, through which he was then explosively ejected. Scorched but safe, he refused to discuss the event with the police and soon left Las Vegas for California and then Florida. The crime is still unsolved.

Mr Rosenthal was not stupid. In his youth in Chicago, his skill at calculating odds of all kinds, whether at the race track or the baseball park, caught the eye of the mob. A career was born. It started with mere bookmaking—illegal, of course—but soon involved other criminal pastimes. Called to give evidence to a congressional committee in 1961, he exercised his Fifth Amendment right to remain silent 37 times, refusing even to say whether he was left-handed (he was, hence his nickname). After that he was convicted of trying to bribe a basketball player, suspected of procuring hand grenades, detonators and fuses for Chicago gangsters, implicated in a bombing in Miami’s “bookie wars” and indicted for racketeering in California.

It was no surprise that he should have been drawn to Las Vegas, a town whose casinos were still largely Mafia-run in the 1960s. Unfortunately, his reputation preceded him and both that and the rekindling of a Chicago friendship with Tony “The Ant” Spilotro, a violent mobster, did Mr Rosenthal no good in the eyes of the regulators. Lefty was therefore employed as a mere floor manager—“the only guy below me was the shoeshine man,” he later remarked—when he was put in charge of four casino-hotels, the Stardust, Hacienda, Fremont and Marina, somewhat to the surprise of the man who thought he had bought them. He had not realised, it seems, that the pension fund of the Teamsters’ union, which had financed his purchase, was controlled by the Mafia.

Mr Rosenthal was a fastidious manager. He made sure that all muffins served on his premises had exactly ten blueberries in them. He was also innovative, introducing to Las Vegas both female croupiers and “sports books”—places where you could bet on games and races in relatively salubrious surroundings. But the authorities would not give him a licence to run a casino and, though he won a brief reprieve from a judge whose daughter had enjoyed a cut-price wedding reception in a hotel where Lefty had been employed, the state of Nevada put him in its “black book” of nasties banned from all casinos.

In later life Mr Rosenthal liked to look back on his heyday as a golden age for Las Vegas, which in his view was to become uncaring once the casinos had been taken over by big companies that knew nothing of “gracious” customer service. Others may imagine Las Vegas in that era as a sort of latter-day Runyonesque Broadway, peopled by characters called Fiore “Fifi” Buccieri, Joey “The Clown” Lombardo and Frank “The German” Schweihs.

They weren’t entirely lovable. It was Frank “The German” who probably tortured Tony “The Ant” and his brother Michael before burying them alive in a cornfield, where they choked to death on their own blood. And Lefty himself was quite candid about the way he dealt with a man found cheating at blackjack. He was zapped with an electric cattle prod and yanked off the floor to the “woodshed”, a back room where his hand was smashed with a rubber mallet—“less likely to leave a mark,” explained Lefty to *Player* magazine in 2005. “I wanted to send a message,” he added; “next time it wouldn’t be a mallet.”

Unlucky only in love

The dolls in Mr Rosenthal’s world were not much more romantic than the guys. The love of his life was Geri McGee, who had been a topless showgirl. They married, but her affair with Tony “The Ant”, and an incident when she pulled a gun on Lefty, prompted him to sue for divorce. She died of an overdose of drugs and Jack Daniel’s soon after the car bombing.

When, in 1995, Martin Scorsese made a film, “Casino”, based on Mr Rosenthal’s life, notoriety turned to celebrity. He had had his own television show and often been on others, but his depiction on screen by Robert De Niro, married to Sharon Stone, inflated his already large ego. For all that, Lefty stayed clear-eyed about his life’s animating activity, gambling. “Winning is virtually impossible,” he would say. “You can get lucky, but it’s just temporary.” Even if he was not simply a gambler, still less a simple one, he may have been the exception that proved the rule.

Overview

Oct 30th 2008
From The Economist print edition

The **Federal Reserve** cut its benchmark interest rate from 1.5% to 1% on October 29th. The Fed said a fall in consumer spending has caused a marked slowdown in the economy, and the recent financial storms are likely to curb spending further.

In **America** the index of consumer confidence published by the Conference Board, a research group, fell from 61.4 to 38.0 in October, a record low for the measure which dates back to 1967. House prices fell by 16.6% in the year to August, according to the S&P/Case-Shiller index of house prices in 20 big cities. Sales of new homes picked up by 2.7% in September, after a big fall in August.

Britain's GDP fell by 0.5% in the third quarter. This was the first quarterly decline in GDP since 1992 and the biggest since 1990.

The People's Bank of **China** cut its one-year lending rate by 27 basis points (hundredths of a percentage point), to 6.66%, the third reduction in six weeks.

The index of **German** business sentiment published by Ifo, a research outfit, fell to a new five-year low in October. Firms were sanguine about current business but gloomier about the outlook.

Norway's central bank cut its main interest rate by half a percentage point, to 4.75%.

Iceland's central bank raised its benchmark interest rate from 12% to 18%, as a condition of an IMF rescue. Two weeks earlier, the bank had cut rates from 15.5%.



Output, prices and jobs

Oct 30th 2008
From The Economist print edition

Output, prices and jobs

% change on year ago

	Gross domestic product				Industrial production	Consumer prices			Unemployment
	latest	qtr*	2008†	2009†	latest	latest	year ago	2008†	rate‡, %
United States	+2.1 Q2	+2.8	+1.6	+0.6	-4.5 Sep	+4.9 Sep	+2.8	+4.5	6.1 Sep
Japan	+0.7 Q2	-3.0	+0.7	+0.6	+0.4 Sep	+2.1 Aug	-0.2	+1.8	4.2 Aug
China	+9.0 Q3	na	+9.8	+8.5	+11.4 Sep	+4.6 Sep	+6.2	+6.4	9.5 2007
Britain	+0.3 Q3	-2.0	+1.1	+0.1	-2.3 Aug	+5.2 Sep§	+1.8	+3.8	5.7 Aug††
Canada	+0.7 Q2	+0.3	+0.8	+1.4	-2.1 Jul	+3.4 Sep	+2.5	+2.8	6.1 Sep
Euro area	+1.4 Q2	-0.7	+1.2	+0.6	-0.7 Aug	+3.6 Sep	+2.1	+3.5	7.5 Aug
Austria	+2.2 Q2	+1.5	+2.1	+1.0	+4.6 Aug	+3.7 Sep	+2.1	+3.0	3.3 Aug
Belgium	+1.9 Q2	+0.9	+1.5	+0.9	-5.0 Aug	+5.5 Sep	+1.5	+4.5	10.9 Sep‡‡
France	+1.1 Q2	-1.3	+1.1	+0.7	-2.6 Aug	+3.0 Sep	+1.5	+3.2	8.0 Aug
Germany	+1.7 Q2	-2.0	+1.6	+0.6	+1.7 Aug	+2.9 Sep	+2.7	+2.9	7.5 Oct
Greece	+3.5 Q2	+3.1	+2.4	+1.5	-1.8 Aug	+4.6 Sep	+2.9	+4.6	7.0 Jul
Italy	-0.1 Q2	-1.1	+0.1	+0.3	-5.3 Aug	+3.8 Sep	+1.7	+3.6	6.8 Q2
Netherlands	+3.0 Q2	+0.5	+2.1	+1.0	-1.3 Aug	+3.1 Sep	+1.3	+2.5	3.8 Sep††
Spain	+1.8 Q2	+0.4	+1.4	+0.3	-11.2 Aug	+4.5 Sep	+2.7	+4.5	11.3 Aug
Czech Republic	+4.6 Q2	+3.6	+4.5	+4.3	-2.6 Aug	+6.6 Sep	+2.8	+6.6	5.3 Sep
Denmark	+0.9 Q2	+1.6	+0.6	+0.8	-0.2 Aug	+4.2 Sep	+1.2	+3.3	1.6 Sep
Hungary	+2.0 Q2	+2.3	+2.0	+3.0	-5.9 Aug	+5.7 Sep	+6.4	+6.7	7.7 Sep††
Norway	+5.9 Q2	+2.4	+2.5	+2.2	-5.7 Aug	+5.3 Sep	-0.3	+3.3	2.4 Jul***
Poland	+5.8 Q2	na	+5.4	+4.3	+7.0 Sep	+4.5 Sep	+2.3	+4.2	8.9 Sep‡‡
Russia	+7.8 Q2	na	+7.5	+6.8	+6.3 Sep	+16.1 Sep	+9.4	+14.0	5.3 Sep‡‡
Sweden	+0.7 Q2	-0.1	+1.3	+1.0	-1.8 Aug	+4.4 Sep	+2.2	+3.8	5.9 Sep‡‡
Switzerland	+2.4 Q2	+1.5	+2.0	+1.1	+6.1 Q2	+2.9 Sep	+0.7	+2.6	2.6 Sep
Turkey	+1.9 Q2	na	+3.7	+3.2	-4.0 Aug	+12.6 Sep	+7.1	+10.2	9.0 Q3‡‡
Australia	+2.7 Q2	+1.1	+2.6	+2.3	+2.8 Q2	+5.0 Q3	+1.9	+4.2	4.3 Sep
Hong Kong	+4.2 Q2	-5.5	+3.8	+2.1	-4.2 Q2	+3.0 Sep	+1.6	+5.3	3.4 Sep††
India	+7.9 Q2	na	+7.3	+6.8	+1.3 Aug	+9.0 Aug	+7.3	+7.9	7.2 2007
Indonesia	+6.5 Q2	na	+5.8	+5.5	+2.9 Aug	+11.0 Sep	+7.0	+10.3	8.5 Feb
Malaysia	+6.3 Q2	na	+5.6	+4.6	+0.9 Aug	+8.2 Sep	+1.8	+5.8	3.5 Q2
Pakistan	+5.8 2008**	na	+6.0	+4.2	-5.6 Aug	+23.9 Sep	+8.4	+21.0	5.6 2007
Singapore	-0.5 Q3	-6.3	+4.0	+3.8	+2.4 Sep	+6.7 Sep	+2.7	+6.5	2.3 Q2
South Korea	+3.9 Q3	+2.3	+4.6	+3.3	+1.9 Aug	+5.1 Sep	+2.3	+4.9	3.1 Sep
Taiwan	+4.3 Q2	na	+4.0	+3.4	-1.4 Sep	+3.1 Sep	+3.1	+3.8	4.1 Sep
Thailand	+5.3 Q2	+2.9	+4.8	+3.9	+7.9 Aug	+6.0 Sep	+2.1	+6.4	1.2 Jun
Argentina	+7.5 Q2	+8.7	+6.2	+2.5	+4.4 Sep	+8.7 Sep	+8.6	+9.0	7.8 Q3‡‡
Brazil	+6.1 Q2	+6.6	+5.3	+2.7	+2.0 Aug	+6.3 Sep	+4.1	+5.8	7.6 Sep‡‡
Chile	+4.3 Q2	+7.4	+3.9	+3.3	-3.1 Aug	+9.2 Sep	+5.8	+8.7	8.2 Aug††‡‡
Colombia	+3.7 Q2	+2.8	+4.5	+4.0	-8.8 Aug	+7.6 Sep	+5.0	+6.7	11.1 Aug‡‡
Mexico	+2.8 Q2	+0.6	+1.9	+0.9	-1.6 Aug	+5.5 Sep	+3.8	+5.3	4.3 Sep‡‡
Venezuela	+7.1 Q2	na	+5.4	+2.7	+3.6 Jul	+36.0 Sep	+15.3	+31.0	7.5 Q2‡‡
Egypt	+6.8 Q2	na	+7.1	+6.7	+6.8 Q2	+21.5 Sep	+9.3	+17.1	9.0 Q1‡‡
Israel	+4.9 Q2	+4.2	+4.2	+2.8	+13.9 Aug	+5.5 Sep	+1.4	+4.8	5.9 Q2
Saudi Arabia	+3.5 2007	na	+7.2	+5.1	na	+10.9 Aug	+5.0	+8.5	na
South Africa	+4.5 Q2	+4.9	+3.4	+3.3	+0.4 Aug	+13.1 Sep	+7.2	+11.3	23.2 Sep‡‡
MORE COUNTRIES Data for the countries below are not provided in printed editions of *The Economist*									
Estonia	-1.1 Q2	-3.2	-1.5	+0.4	-2.6 Aug	+10.5 Sep	+7.2	+10.5	4.0 Jul
Finland	+2.4 Q2	+3.1	+2.6	+1.1	-1.1 Aug	+4.7 Sep	+2.6	+4.0	6.5 Sep
Iceland	+5.0 Q2	+20.9	nil	+0.8	+0.4 2007	+15.9 Oct	+4.5	+12.0	1.3 Sep‡‡
Ireland	-0.8 Q2	-2.1	-0.5	-0.1	+4.2 Aug	+4.3 Sep	+4.6	+4.0	6.3 Sep
Latvia	+0.1 Q2	na	-0.4	-0.5	-11.1 Aug	+14.9 Sep	+11.4	+15.8	5.7 Jul
Lithuania	+3.1 Q3	+1.6	+5.1	+3.7	na	+11.1 Sep	+7.0	+10.8	4.7 Aug‡‡
Luxembourg	+2.8 Q2	+4.5	+2.8	+2.6	+11.9 Aug	+4.0 Sep	+2.1	+4.0	4.2 Aug‡‡
New Zealand	-0.3 Q2	-2.1	+0.4	+1.5	+2.4 Q2	+5.1 Q3	+1.8	+4.1	3.9 Q2
Peru	+8.9 Aug	na	+9.1	+6.5	+5.6 Aug	+6.2 Sep	+2.8	+5.7	8.6 Aug††
Philippines	+4.6 Q2	+8.4	+4.5	+3.9	+8.1 Jul	+11.9 Sep	+2.7	+9.7	7.4 Q3‡‡
Portugal	+0.7 Q2	+1.4	+1.4	+1.3	-0.4 Aug	+3.1 Sep	+2.1	+2.7	7.3 Q2‡‡
Slovakia	+7.6 Q2	na	+7.0	+5.2	+0.9 Aug	+5.4 Sep	+2.9	+4.4	7.5 Sep‡‡
Slovenia	+5.5 Q2	na	+4.5	+3.5	-7.1 Aug	+5.5 Sep	+3.5	+6.0	6.4 Aug‡‡

*% change on previous quarter, annual rate. †*The Economist* poll or Economist Intelligence Unit estimate/forecast. ‡National definitions.- §RPI inflation rate 5.0% in Sept. ††Latest three months. ‡‡Not seasonally adjusted. ***Centred 3-month average

Sources: National statistics offices and central banks; Thomson Datastream; Reuters; Centre for Monitoring Indian Economy; OECD; ECB

The Economist commodity-price index

Oct 30th 2008
From The Economist print edition

The Economist commodity-price index

2000=100

	Oct 21st	Oct 28th*	% change on one month	% change on one year
Dollar index				
All items	172.4	164.7	-21.5	-23.4
Food	184.0	174.6	-18.6	-10.3
Industrials				
All	157.4	151.8	-25.5	-37.0
Nfa†	139.7	129.4	-23.7	-25.7
Metals	167.2	164.1	-26.3	-40.9
Sterling index				
All items	154.2	160.1	-10.3	+1.6
Euro index				
All items	120.9	122.1	-11.6	-11.4
Gold				
$ per oz	773.55	738.15	-15.9	-5.9
West Texas Intermediate				
$ per barrel	71.00	63.20	-37.6	-29.8

*Provisional †Non-food agriculturals.

Income inequality

Oct 30th 2008
From The Economist print edition



Income inequality in rich countries has increased in the past two decades, according to a new report from the OECD, a think-tank. Between the mid-1980s and the middle of this decade, the Gini coefficient, which measures the spread of income levels, rose by an average of 0.02 (or 7%) for the 24 mostly rich OECD countries that make data available. Some of the countries, such as Finland, that recorded the largest increases, started from a position in which incomes were spread relatively equally. Countries such as the United States and New Zealand saw large increases from an already unequal base. Income inequality has declined in some countries, with the largest falls in France and Spain.



Trade, exchange rates, budget balances and interest rates

Oct 30th 2008
From The Economist print edition

Trade, exchange rates, budget balances and interest rates

	Trade balance* latest 12 months, $bn	Current-account balance latest 12 months, $bn	Current-account balance % of GDP 2008†	Currency units, per $ Oct 29th	Currency units, per $ year ago	Budget balance % of GDP 2008†	Interest rates, % 3-month latest	Interest rates, % 10-year gov't bonds, latest
United States	−848.0 Aug	−699.0 Q2	−4.7	-	-	−2.5	1.95	3.87
Japan	+77.9 Aug	+197.3 Aug	+3.9	97.5	115	−3.0	0.80	1.50
China	+258.0 Sep	+371.8 2007	+8.5	6.85	7.46	0.4	4.13	3.23
Britain	−188.9 Aug	−82.9 Q2	−3.1	0.61	0.48	−3.8	6.10	4.40
Canada	+50.8 Aug	+13.6 Q2	+1.1	1.23	0.95	0.2	2.15	3.80
Euro area	−26.4 Aug	−36.2 Aug	−0.4	0.78	0.69	−0.9	4.83	3.79
Austria	−0.1 Jul	+14.5 Q2	+2.6	0.78	0.69	−1.0	4.83	4.37
Belgium	+3.3 Jul	−9.8 Jun	+1.6	0.78	0.69	−0.6	4.89	4.44
France	−76.9 Aug	−54.2 Aug	−1.8	0.78	0.69	−2.9	4.83	4.13
Germany	+279.8 Aug	+269.3 Aug	+6.5	0.78	0.69	1.1	4.83	3.79
Greece	−67.2 Jul	−50.8 Aug	−14.0	0.78	0.69	−3.3	4.83	5.28
Italy	−15.4 Aug	−71.1 Aug	−2.5	0.78	0.69	−2.6	4.83	4.89
Netherlands	+60.1 Aug	+62.5 Q2	+6.2	0.78	0.69	0.7	4.83	4.25
Spain	−154.9 Aug	−165.2 Jul	−9.8	0.78	0.69	−1.6	4.83	4.42
Czech Republic	+6.4 Aug	−4.3 Aug	−2.8	18.5	18.6	−1.9	4.47	4.85
Denmark	+6.4 Aug	+5.9 Aug	+1.3	5.80	5.15	3.8	7.30	4.50
Hungary	+0.5 Aug	−8.8 Q2	−5.5	199	174	−3.8	12.17	11.35
Norway	+83.2 Sep	+78.1 Q2	+17.3	6.71	5.39	17.7	6.34	4.16
Poland	−22.2 Aug	−26.3 Aug	−4.9	2.76	2.51	−1.9	6.86	6.48
Russia	+200.3 Aug	+116.5 Q3	+6.2	26.9	24.7	4.5	11.00	8.80
Sweden	+19.0 Sep	+38.6 Q2	+7.6	7.68	6.36	2.4	3.28	3.48
Switzerland	+17.3 Sep	+60.2 Q2	+13.0	1.14	1.16	0.9	2.81	2.62
Turkey	−76.0 Aug	−48.7 Aug	−6.4	1.52	1.17	−1.8	21.64	12.20‡
Australia	−15.6 Aug	−61.1 Q2	−5.1	1.50	1.08	1.3	5.87	5.21
Hong Kong	−26.1 Sep	+27.5 Q2	+10.8	7.75	7.75	0.7	3.54	2.30
India	−100.3 Aug	−21.9 Q2	−2.9	49.7	39.3	−4.3	7.17	8.09
Indonesia	+19.0 Sep	+6.3 Q2	+2.8	10,800	9,097	−2.0	12.43	14.79‡
Malaysia	+41.0 Aug	+35.3 Q2	+13.7	3.58	3.34	−4.8	3.66	6.43‡
Pakistan	−22.5 Sep	−14.0 Q2	−7.2	81.7	60.7	−6.7	14.26	26.18‡
Singapore	+22.9 Sep	+32.8 Q2	+18.6	1.50	1.45	1.0	1.21	2.91
South Korea	−11.7 Sep	−10.6 Sep	−3.3	1,427	901	1.1	5.83	5.61
Taiwan	+6.9 Sep	+32.6 Q2	+5.6	33.3	32.4	−1.8	2.60	2.08
Thailand	+5.4 Aug	+7.8 Aug	+1.1	34.9	34.0	−2.9	3.85	3.86
Argentina	+15.9 Sep	+6.0 Q2	+2.8	3.37	3.15	0.7	17.44	na
Brazil	+28.8 Sep	−25.2 Sep	−1.8	2.13	1.74	−1.6	13.66	6.16‡
Chile	+16.1 Sep	+1.0 Q2	−0.5	668	494	6.5	9.12	5.30‡
Colombia	+1.8 Jul	−4.9 Q2	−2.6	2,375	1,990	−1.0	10.20	9.64‡
Mexico	−11.3 Sep	−5.3 Q2	−0.8	12.9	10.7	nil	7.22	9.16
Venezuela	+41.9 Q2	+37.8 Q2	+14.8	4.95	4.23§	1.6	17.01	6.55‡
Egypt	−23.4 Q2	+0.9 Q2	+0.2	5.59	5.52	−7.1	12.76	7.49‡
Israel	−13.7 Sep	+3.5 Q2	+0.9	3.80	3.96	−0.8	3.24	5.39
Saudi Arabia	+150.8 2007	+95.0 2007	+33.1	3.75	3.74	13.3	4.59	na
South Africa	−10.3 Aug	−22.5 Q2	−7.7	10.0	6.54	0.2	12.45	9.10
MORE COUNTRIES Data for the countries below are not provided in printed editions of *The Economist*								
Estonia	−4.3 Aug	−3.3 Aug	−11.8	12.2	10.8	−0.5	6.82	na
Finland	+11.9 Aug	+10.6 Aug	+3.8	0.78	0.69	4.5	4.86	4.29
Iceland	−0.9 Sep	−4.5 Q2	−14.6	119	59.8	2.0	18.47	na
Ireland	+39.0 Aug	−15.8 Q2	−3.5	0.78	0.69	−3.9	4.83	4.64
Latvia	−6.9 Aug	−5.5 Aug	−15.0	0.55	0.49	−1.5	9.98	na
Lithuania	−8.0 Aug	−6.8 Aug	−14.0	2.69	2.39	−0.7	8.03	na
Luxembourg	−6.9 Jul	+5.1 Q2	na	0.78	0.69	0.5	4.83	na
New Zealand	−3.7 Sep	−11.4 Q2	−7.1	1.71	1.30	0.3	6.85	5.95
Peru	+6.3 Aug	−1.5 Q2	−1.6	3.10	3.00	2.7	6.50	na
Philippines	−8.5 Aug	+4.3 Jun	+2.0	49.2	43.7	−0.9	4.38	na
Portugal	−32.9 Jul	−27.9 Jul	−9.0	0.78	0.69	−2.5	4.83	4.61
Slovakia	−0.9 Aug	−5.6 Jun	−5.6	23.7	23.0	−2.1	1.66	4.52
Slovenia	−4.5 Aug	−3.5 Aug	−6.6	0.78	0.69	0.4	4.83	na

*Merchandise trade only. †*The Economist* poll or Economist Intelligence Unit forecast. ‡Dollar-denominated bonds. §Unofficial exchange rate.
Sources: National statistics offices and central banks; Thomson Datastream; Reuters; JPMorgan; Bank Leumi le-Israel; Centre for Monitoring Indian Economy; Danske Bank; Hong Kong Monetary Authority; Standard Bank Group; UBS; Westpac.



Markets

Oct 30th 2008
From The Economist print edition

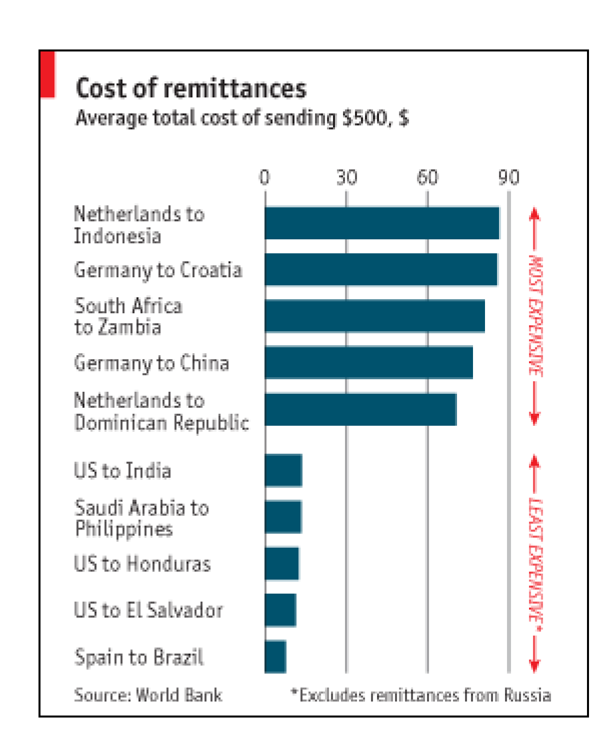
Markets

	Index	% change on		
			Dec 31st 2007	
	Oct 29th	one week	in local currency	in $ terms
United States (DJIA)	8,991.0	+5.5	-32.2	-32.2
United States (S&P 500)	930.1	+3.7	-36.7	-36.7
United States (NAScomp)	1,657.2	+2.6	-37.5	-37.5
Japan (Nikkei 225)	8,211.9	-5.3	-46.4	-38.5
Japan (Topix)	830.3	-6.6	-43.7	-35.5
China (SSEA)	1,807.0	-9.3	-67.3	-65.1
China (SSEB, $ terms)	86.7	-16.1	-77.8	-76.3
Britain (FTSE 100)	4,242.5	+5.0	-34.3	-46.2
Canada (S&P TSX)	9,501.6	+2.9	-31.3	-44.9
Euro area (FTSE Euro 100)	763.7	+1.7	-44.5	-51.2
Euro area (DJ STOXX 50)	2,515.2	+2.3	-42.8	-49.8
Austria (ATX)	1,821.5	-7.7	-59.6	-64.5
Belgium (Bel 20)	2,022.9	+2.8	-51.0	-56.9
France (CAC 40)	3,402.6	+3.2	-39.4	-46.7
Germany (DAX)*	4,808.7	+5.2	-40.4	-47.6
Greece (Athex Comp)	1,969.8	-2.8	-62.0	-66.6
Italy (S&P/MIB)	20,466.0	-3.0	-46.9	-53.3
Netherlands (AEX)	259.6	+1.8	-49.7	-55.8
Spain (Madrid SE)	926.8	-4.1	-43.6	-50.4
Czech Republic (PX)	791.9	-7.3	-56.4	-57.1
Denmark (OMXCB)	246.0	-6.1	-45.2	-51.8
Hungary (BUX)	13,399.1	+12.4	-48.9	-55.7
Norway (OSEAX)	267.1	-8.9	-53.1	-62.1
Poland (WIG)	27,497.0	+0.8	-50.6	-56.0
Russia (RTS, $ terms)	644.0	-3.3	-69.1	-71.9
Sweden (Aff.Gen)	187.3	-4.7	-45.0	-53.7
Switzerland (SMI)	5,880.6	-0.8	-30.7	-31.0
Turkey (ISE)	24,895.2	-2.8	-55.2	-65.3
Australia (All Ord.)	3,805.8	-7.6	-40.7	-54.7
Hong Kong (Hang Seng)	12,702.1	-11.0	-54.3	-54.1
India (BSE)	9,044.5	-11.1	-55.4	-64.6
Indonesia (JSX)	1,113.6	-19.3	-59.4	-64.7
Malaysia (KLSE)	829.4	-8.3	-42.6	-47.0
Pakistan (KSE)	9,182.9	nil	-34.8	-50.8
Singapore (STI)	1,671.2	-8.2	-51.8	-53.7
South Korea (KOSPI)	969.0	-14.6	-48.9	-66.5
Taiwan (TWI)	4,406.5	-9.4	-48.2	-49.5
Thailand (SET)	384.2	-17.4	-55.2	-56.7
Argentina (MERV)	918.5	-2.4	-57.3	-60.1
Brazil (BVSP)	34,845.0	-0.6	-45.5	-54.4
Chile (IGPA)	11,590.2	+0.8	-17.7	-38.7
Colombia (IGBC)	6,958.7	-4.5	-34.9	-44.7
Mexico (IPC)	19,157.3	+2.0	-35.1	-45.2
Venezuela (IBC)	35,933.6	-1.4	-5.2	-58.9
Egypt (Case 30)	4,887.1	-4.4	-53.3	-53.9
Israel (TA-100)	643.3	-6.2	-44.3	-43.5
Saudi Arabia (Tadawul)	5,537.8	-10.1	-49.8	-49.8
South Africa (JSE AS)	19,794.7	-2.4	-31.6	-53.3
Europe (FTSEurofirst 300)	897.1	+2.7	-40.5	-47.7
World, dev'd (MSCI)	924.3	+1.6	-41.8	-41.8
Emerging markets (MSCI)	507.5	-5.1	-59.3	-59.3
World, all (MSCI)	226.3	+1.0	-43.9	-43.9
World bonds (Citigroup)	738.3	+0.3	+1.1	+1.1
EMBI+ (JPMorgan)	334.6	+4.0	-22.8	-22.8
Hedge funds (HFRX)	1,060.9	-2.1	-20.2	-20.2
Volatility, US (VIX)	70.0	69.7	22.5 (levels)	
CDSs, Eur (iTRAXX)†	159.0	+6.2	+214.1	+176.1
CDSs, N Am (CDX)†	227.4	+4.8	+191.9	+191.9
Carbon trading (EU ETS) €	18.5	-7.1	-16.8	-26.9

*Total return index. †Credit-default swap spreads, basis points.
Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; JPMorgan Chase; Bank Leumi le-Israel; CBOE; CMIE; Danske Bank; EEX; HKMA; Markit; Standard Bank Group; UBS; Westpac.

Cost of remittances

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From The Economist print edition



As many as 190m migrant workers sent money home in 2007, according to the World Bank. Remittances that could be tracked reached $337 billion last year, of which $251 billion went to developing countries. The cost of sending money depends on both its source and its destination. On average, it costs only $7.68 to send $500 from Spain to Brazil, a 1.5% fee. By contrast, it costs a whopping $86.41 (a charge of 17.3%) to send the same sum from the Netherlands to Indonesia. The Netherlands, Germany and Japan tend to be the most expensive places to send money from. Remittance costs are generally lowest in Russia, Saudi Arabia, Spain, Singapore, America and Britain.